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TRADE LAW MODERNIZATION ACT

MF 140 ORIGINAL

HEARINGS

BEFORE THE

SUBCOMMITTEE ON COMMERCE, TRANSPORTATION, AND TOURISM

OF THE

COMMITTEE ON ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

ON

H.R. 1950

A BILL TO GIVE THE NATION'S PERFORMANCE IN INTERNATIONAL TRADE APPROPRIATELY GREATER IMPORTANCE IN THE FORMULATION OF GOVERNMENT POLICY, TO MODERNIZE THE REMEDIES AVAILABLE TO UNITED STATES PRODUCERS REGARDING UNFAIR AND INJURIOUS FOREIGN TRADE PRACTICES, AND FOR OTHER PURPOSES

JUNE 26 AND OCTOBER 3, 1985

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U.S. GOVERNMENT PRINTING OFFICE
58-055 O WASHINGTON : 1986

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TRADE LAW MODERNIZATION ACT

WEDNESDAY, JUNE 26, 1985

House of Representatives,
Committee on Energy and Commerce,
Subcommittee on Commerce,
Transportation, and Tourism,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:20 a.m. in room 2123, Rayburn House Office Building, Hon. James J. Florio (chairman) presiding.

Mr. Florio. The subcommittee will kindly come to order. We would ask, to the degree possible, that people take their seats and at least remain quiet so that we can proceed with our hearing this morning. As I suspect many in the audience know, the Congress was in until very late last night, we had a 7-hour markup in the subcommittee yesterday, so that everyone is somewhat fatigued, but hopefully the stimulating presentations this morning will sparkle the sensitivity of the members of the subcommittee as they arrive.

I'd like to welcome all in attendance to this morning's hearing on H.R. 1950, the Trade Law Modernization Act. We have a distinguished group of witnesses, and I'm looking forward to their comments as they try to clarify some very murky areas for the members of the subcommittee as well as for the Congress.

Trade seems to be the No. 1 or 2 item, almost, on every Member of Congress agenda. That a good number of Congressmen, Democrats and Republicans, are of the opinion that there's a need to focus on trade and that we have to formulate some policies if this Nation is to remain strong and viable economically in the world trade arena.

There now seems to be, in my opinion, more than enough support for legislation imposing new trade sanctions on firms of foreign governments that deny U.S. companies equivalent access to their markets. The word that appears to be in is "reciprocity." I think that is appropriate.

The legislation that we're considering today reflects this new consensus that is evolving. The comprehensive trade reform package that we have before us was developed by 9 of our Nation's largest and most competitive companies, together with 10 of our largest, most progressive, forward-thinking trade unions. Business and labor together are advocating fundamental changes in U.S. trade policy. Some would say that we're advocating the formulation of a trade policy because some have suggested that we do not have a trade policy.

This new policy seems to be based on the commitment to open market access measured in terms of actual trade performance. To achieve such access, there is also a clear recognition of the important role that trade sanctions must play. The bill, therefore, would facilitate the imposition of trade sanctions against foreign firms when it is determined to be appropriate.

I'd like to thank all of our witnesses in advance for their contribution to the subcommittee's trade deliberations this year. We're looking forward to working with all who have an interest in this matter, and there are a number of other pieces of legislation that we'll be dealing with in a more restricted area.

This hearing is designed to look at the broad picture and the scope and the context of broad legislation that's been introduced.

I would yield to the gentleman from Pennsylvania at this point for any comments he might make.

Mr. RITTER. Thank you, Mr. Chairman. I would just like to thank our distinguished list of witnesses for being here today and sharing with us their ideas on this, as the chairman says, major problem for our country.

I represent a district in Pennsylvania, the Lehigh Valley, which is one of the top manufacturing districts in the country, and I don't think there is a district that is more affected by the kind of trade policies this Nation engages in.

So I look forward, Mr. Chairman, to the testimony and yield back the balance of my time. Thank you.

[Testimony resumes on p. 95.]

[The text of H.R. 1950 and agency report follows:]

I

99TH CONGRESS
1ST SESSION

H. R. 1950

To give the Nation's performance in international trade appropriately greater importance in the formulation of government policy, to modernize the remedies available to United States producers regarding unfair and injurious foreign trade practices, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

APRIL 3, 1985

Mr. GUARINI (for himself and Mr. DUNCAN) introduced the following bill; which was referred jointly to the Committees on Ways and Means and Energy and Commerce

---

A BILL

To give the Nation's performance in international trade appropriately greater importance in the formulation of government policy, to modernize the remedies available to United States producers regarding unfair and injurious foreign trade practices, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Trade Law Modernization Act of 1985".

SEC. 2. TABLE OF CONTENTS.

Sec. 1. Short title.

Sec. 2. Table of contents.
Sec. 3. Statement of purpose.
Sec. 4. Definitions.

TITLE I—NATIONAL TRADE POLICY AND NEGOTIATING OBJECTIVES; NEGOTIATION AUTHORITY

Sec. 101. Declaration of national trade policy objectives.
Sec. 102. Procedure for establishing trade agenda.
Sec. 103. Negotiating objectives.
Sec. 104. Negotiating authority with respect to foreign government procurement and domestic government actions that substantially alter United States market access.

TITLE II—TRANSFER OF AUTHORITY TO ADMINISTERING AUTHORITY; AMENDMENTS TO TITLE I OF TRADE ACT OF 1974

Sec. 201. Transfer of authority to the Administering Authority.
Sec. 202. Establishment of sectoral research and monitoring capability.
Sec. 203. Advisory system.
Sec. 204. Balance of payments authority.

TITLE III—RELIEF FROM INJURY CAUSED BY IMPORT COMPETITION

Sec. 301. Investigations under section 201 of Trade Act of 1974.
Sec. 302. Provisional relief upon finding of critical circumstances.
Sec. 303. Consultations with foreign governments.
Sec. 304. Industry assessment and competitiveness strategy.
Sec. 305. Import relief.

TITLE IV—RELIEF FROM INJURIOUS INDUSTRIAL TARGETING AND UNFAIR TRADE PRACTICES

Sec. 401. Enforcement of United States rights under trade agreements and response to injurious industrial targeting and other foreign practices.
Sec. 402. Investigations under title III of the Trade Act of 1974.
Sec. 403. Mandatory action in cases of injurious industrial targeting.

TITLE V—COUNTERVAILING AND ANTIDUMPING DUTIES

Sec. 501. Limitations on acceptance of country under the Agreement.
Sec. 502. Natural resource subsidies.
Sec. 503. Foreign market value.
Sec. 504. Threat of injury.

SEC. 3. STATEMENT OF PURPOSE.

The purpose of this Act is—

(1) to promote the growth of employment, a higher level of real income, and a diversified industrial

economy in the United States through increased, balanced, and equitable international trade;

(2) to establish open and fair competition for foreign products in the United States market and for United States products in foreign markets;

(3) to provide improved procedures and remedies against unfair trade practices and new responses to foreign government practices (including injurious industrial targeting) that affect international trade and cause substantial harm to United States firms and workers;

(4) to promote more effective adjustment of domestic industry to foreign competition by encouraging modernization efforts of firms and workers;

(5) to provide better information and analysis of developments in international trade and industrial competitiveness that affect United States firms and workers;

(6) to set forth a national trade policy endorsed by both the Congress and the President;

(7) to strengthen the authority of the Executive branch to deal with closed foreign markets and unfair foreign trade practices; and

(8) to make trade policy formulation more reflective of national trade priorities by creating a process of

consultation with the private sector and the Congress on trade policy priorities and decisions.

SEC. 4. DEFINITIONS.

For purposes of this Act—

(1) The term "Administering Authority" means the United States Trade Representative or any officer of the United States to whom the responsibility for carrying out the duties of the Administering Authority under this Act are transferred by law.

(2) The term "GATT" means the General Agreement on Tariffs and Trade.

TITLE I—NATIONAL TRADE POLICY AND NEGOTIATING OBJECTIVES; NEGOTIATION AUTHORITY

SEC. 101. DECLARATION OF NATIONAL TRADE POLICY OBJECTIVES.

(a) The Congress finds that—

(1) a prosperous, growing, and diversified national economy depends upon the economic position of the United States in the world economy, and

(2) enhanced international competitiveness of United States industries must, therefore, be an urgent national priority.

(b) The Congress declares the following as national trade policy objectives that shall guide the conduct of United States trade policy and domestic economic policy:

(1) a strong performance in international trade, based on a technologically advanced industrial economy, is necessary to support the Nation's defense and maintain the international strategic commitments of the United States;

(2) international trade should maintain and enhance the Nation's standard of living by contributing to increases in productivity;

(3) international trade should promote domestic employment through an expanding and diversified domestic economy;

(4) international trade should assist the economic development of developing countries and help to raise the standard of living in those countries; and

(5) international trade should support the growth of the world economy and mutuality of interests among nations and strengthen the ties of the United States with its major trading partners.

(c) To achieve the national trade policy objectives described in subsection (b), the Congress finds that United States trade policy should—

(1) open the world's markets to United States exports on the basis of reciprocity and mutual beneficiality;

(2) provide for vigorous enforcement of unfair trade practice laws, and periodically review their adequacy and relevance, to prevent harm to United States firms and workers and to maintain a system of fair trade;

(3) provide a consistent policy of support for United States exports, including minimization of the degree of export restrictions and maximization of the degree of export financial support if necessary to offset the support provided by foreign governments to their exporters;

(4) pursue international negotiations to attain common rules to restrict international lending, export credits and other forms of financial assistance to industries in global overcapacity;

(5) support policies that promote the international competitiveness of United States industries;

(6) prevent abuses of the international trading system which result from any combination of coordinated foreign government actions, whether carried out severally or jointly, that are bestowed on a specific enterprise, industry, or group the effect of which is to

assist the beneficiary to become more competitive in the export of any class or kind of merchandise, resulting in material injury to other countries; and

(7) provide appropriate assistance to domestic firms and workers in industries that are facing serious trade problems.

SEC. 102 PROCEDURE FOR ESTABLISHING TRADE AGENDA.

(a)(1) By no later than March 1 of each year, the Administering Authority shall submit in writing (in confidence if appropriate) to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives a statement of the actions the Administering Authority proposes to take during such year to achieve the objectives described in section 101, including but not limited to contemplated actions under this Act or title III of the Trade Act of 1974 and any negotiations contemplated with foreign countries.

(2) Prior to submitting the statement required under paragraph (1), the Administering Authority shall seek advice from the appropriate sector advisory committees established under section 135 of the Trade Act of 1974 (19 U.S.C. 2155).

(b) The Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives shall hold annual hearings on the objectives and priorities of United States trade policy at which interested members of the public may present their views. After the close of such hearings, the Administering Authority shall consult with such committees concerning the record of the hearings.

(c) The committees described in subsection (b) shall by formal vote accept, reject, or modify the proposals submitted under subsection (a) on the basis of the hearings and consultations provided for under subsection (b) and shall submit formal advice on such proposals in writing (in confidence, if appropriate) to the Administering Authority.

SEC. 103 NEGOTIATING OBJECTIVES.

The objectives of the United States in any trade negotiations shall be—

(1) to obtain—

(A) more open and equitable market access abroad for the products and services of the United States;

(B) the reduction and elimination of the adverse effects of acts, policies, or practices of foreign entities which distort trade or commerce; and

(C) improved effectiveness of the rules governing international trade;

(2) to develop internationally accepted rules, including dispute settlement procedures, which—

(A) increase the discipline provided by the international trading system (consistent with the remedies provided by the laws of the United States) with respect to policies, acts, and practices that may adversely affect the trade or commerce of other participants;

(B) limit or offset the injurious effects of any combination of coordinated foreign government actions, whether carried out severally or jointly, that are bestowed on a specific enterprise, industry, or group thereof, the effect of which is to assist the beneficiary to become more competitive in the export of any class or kind of merchandise;

(C) ensure that the GATT Government Procurement Code provides substantially equivalent competitive opportunties for United States products in sectors now excluded by foreign governments;

(D) provide for common standards and procedures, including international coordination and transparency of safeguard actions, to avoid the harmful effects of trade diversion and unregulated protective actions;

(E) provide for greater discipline to restrict export subsidies by, inter alia—

(i) expanding the list of proscribed export subsidies,

(ii) use of the GATT system to reinforce agreements curbing the export credit race, and

(iii) renegotiating the terms of the GATT Subsidies Code with respect to conditions for developing country accession to the Code; and

(F) regulate the expanding use of countertrade requirements in international trade; and

(3) to promote international cooperation in trade and monetary policies in order to—

(A) facilitate the expansion and balanced growth of world trade and to contribute to the maintenance and promotion of high levels of employment and real income in the United States and its trading partners;

(B) promote exchange rate stability and to maintain orderly exchange rate arrangements;

(C) assist in establishing a new multilaterial exchange rate and payments system that will avoid the recent periods of United States dollar overvaluation and undervaluation and stabilize the dollar at a level consistent with long-term current account balance;

(D) avoid the depressing effects on world trade and national economies of overly restrictive general stabilization policies for many debt-ridden countries at the same time; and

(E) seek a long-term solution to the debt repayment problems of developing countries that does not hinder the growth and expansion of world trade and United States exports.

SEC. 104. NEGOTIATING AUTHORITY WITH RESPECT TO FOREIGN GOVERNMENT PROCUREMENT AND DOMESTIC GOVERNMENT ACTIONS THAT SUBSTANTIALLY ALTER UNITED STATES MARKET ACCESS.

(a) The Congress finds that—

(1) discriminatory procurement practices and regulatory requirements of foreign governments are denying United States producers fair and equitable market opportunities;

(2) many overseas markets are closed to American producers because foreign governments purchase such products only from their own domestic producers, or require domestic purchasers to purchase from domestic sources;

(3) judicial and administrative actions in the United States have opened markets in the United States to the products of foreign countries while those foreign markets remain closed to United States products;

(4) the GATT Government Procurement Code does not address such problems because many industrial sectors are excluded from coverage under the Code;

(5) because procurement is open in the United States and closed in other markets, United States producers are denied benefits that foreign producers have such as—

(A) unit cost reductions from a greater scale of production,

(B) more timely recoupment of research and development expenditures and other fixed costs, and

(C) a guaranteed (riskless) market in the home country; and

(6) such lack of fair and equitable market opportunities results in—

(A) lower United States investment,

(B) less research and development and product innovation, and

(C) lower ouput and employment levels, than would be the case if United States products could compete on a fair basis in foreign markets.

(b) In order to remedy the harmful effects on United States trade of discriminatory procurement practices and regulatory requirements of foreign countries or instrumentalities, the Administering Authority shall seek to obtain fair and equitable market opportunities through consultations or negotiations with the foreign countries or instrumentalities involved.

(c) In addition to the action authorized in subsection (b), the Administering Authority may—

(1) suspend, withdraw, or prevent the application of, or refrain, from proclaiming, benefits under any trade agreement with the foreign country or instrumentality referred to in subsection (b);

(2) direct customs officers to impose—

(A) duties or other import restrictions on the goods of, and

(B) notwithstanding any other provisions of law, fees or restrictions on the services of,

the foreign country or instrumentality referred to in subsection (b) for such time and in such an amount or to such a degree as the Administering Authority determines necessary; and

(3) make available sufficient analysis and information to other agencies and courts of the United States Government for the purpose of ensuring consideration by such agencies and courts of the competitive impact of pending administrative or judicial decisions of such agencies or courts that could significantly enlarge the access of foreign products and services to the United States market.

(4) recommend action respecting service sector access authorization to the President, who may take action as authorized by section 301(d) of the Trade Act of 1974, as amended by this Act.

(d)(1) If the Administering Authority finds a significant denial of fair and equitable market opportunities in the markets of any foreign country to products or services of the United States in any sector of the economy with respect to which domestic actions taken by the United States since 1980 have resulted in substantial new market opportunities in the United States for the products or services of any foreign country or instrumentality, the Administering Authority shall—

(A) act to obtain fair and equitable market opportunities in the markets of such foreign country, and

(B) pending achievement of such opportunities, impose conditions of access to United States markets that are equivalent in effect to the conditions that existed before such domestic actions were taken by the United States.

(2)(A) The actions authorized under paragraph (1) may include those described in subsection (c).

(B) The Administering Authority may submit to the Congress any proposed legislation that may be necessary to impose the conditions of access described in paragraph (1)(B). Such proposed legislation shall be subject to the same rules applicable to an implementing bill under section 151 of the Trade Act of 1974 (19 U.S.C. 2191).

(e) Action may be taken under subsections (b), (c), and (d), and upon motion of the Administering Authority or after investigation upon the filing of a petition by any interested person. Such petition and investigation shall be subject to the provisions of title III of the Trade Act of 1974, except that action shall be taken under section 305(b)(2) if the determination under section 305(b)(1) is affirmative.

(f) For purposes of this section—

(1) The term "service sector access authorization" means any license, permit, order, or other authorization issued under the authority of Federal law that gives a foreign supplier of services access to the United States market in a particular service sector.

(2)(A) The term "denial of fair and equitable market opportunities" means commercial opportunities and results in foreign markets that are unfair and inequitable compared to commercial opportunities and results in the United States.

(B) The Administering Authority shall find a denial of fair and equitable market opportunity in any case in which the market opportunity in the United States of products of a foreign country that are competitive in terms of price and quality is greater than the market opportunity in such foreign country of similarly competitive products of the United States.

TITLE II—TRANSFER OF AUTHORITY TO ADMINISTERING AUTHORITY; AMENDMENTS TO TITLE I OF TRADE ACT OF 1974

SEC. 201. TRANSFER OF AUTHORITY TO THE ADMINISTERING AUTHORITY.

(a) Subsections (b), (c), and (d) and paragraphs (3) and (4) of subsection (a) of section 406 of the Trade Act of 1974 (19 U.S.C. 2436) are each amended by striking out "President" each place it appears and inserting in lieu thereof "Administering Authority".

(b)(1) Title V of the Trade Act of 1974 (19 U.S.C. 2461 et seq.) is amended by striking out "President" each place it appears and inserting in lieu thereof "Administering Authority".

(2) Subsection (a) of section 502 of the Trade Act of 1974 (19 U.S.C. 2462) is amended by—

(A) by striking out "with respect to which there is in effect an Executive order" in paragraph (1) and inserting in lieu thereof "which is designated",

(B) by striking out "of the United States designating such country" in paragraph (1),

(C) by striking out the parenthetical clause in paragraph (2), and

(D) by striking out "by Executive order" in paragraph (3).

(3) Section 503 of the Trade Act of 1974 (19 U.S.C. 2463) is amended—

(A) by striking out the second sentence in subsection (a) and inserting in lieu thereof the following new sentence: "Before any such list is furnished to the Commission, there shall be in effect a designation of beneficiary developing countries under section 502.",

(B) by striking out "under section 101" in the third sentence of subsection (a) and inserting in lieu thereof "in section 101, except that all advice shall be presented to the Administering Authority.",

(C) by striking out "by Executive order" in the last sentence of subsection (a), and

(D) by striking out "United States Trade Representative" in subsection (b) and inserting in lieu thereof "Administering Authority".

(4) Subsection (b) of section 504 of the Trade Act of 1974 (19 U.S.C. 2464(b)) is amended by striking out "issues an Executive order revoking" in the last sentence and inserting in lieu thereof "revokes".

(c) Subsection (g) of section 337 of the Tariff Act of 1930 (19 U.S.C. 1337(g)) is amended—

(1) by striking out "President" each place it appears and inserting in lieu thereof "Administering Authority",

(2) by adding at the end thereof the following new paragraph:

"(5) For purposes of this subsection, the term 'Administering Authority' has the meaning given to such term by section 601(11) of the Trade Act of 1974.".

(d) Section 601 of the Trade Act of 1974 (19 U.S.C. 2481) is amended by adding at the end thereof the following new paragraph:

"(11) The term 'Administering Authority' means the United States Trade Representative or any officer of the United States to whom the responsibility for carrying out the duties of the Administering Authority under this Act are transferred by law.".

SEC. 202. ESTABLISHMENT OF SECTORAL RESEARCH AND MONITORING CAPABILITY.

(a) Title I of the Trade Act of 1974 is amended by adding at the end thereof the following new chapter:

"CHAPTER 9—RESEARCH AND MONITORING

"SEC. 185. ESTABLISHMENT OF SECTORAL RESEARCH AND MONITORING CAPABILITY.

"(a) The Secretary of Commerce shall establish and implement a continuing program to assess and evaluate the industrial and trade policies of other countries and the effects of such policies on United States industries, trade, and employment (including the effect on the export competitiveness of specific enterprises, industries, or groups thereof).

"(b) In implementing the program described in subsection (a), the Secretary of Commerce shall give priority to those foreign countries and product sectors in which the United States has significant economic and commercial interests. The Secretary of Commerce shall consult with appropriate Federal agencies and private sector advisory groups in determining such priorities.

"(c) The Secretary of Commerce shall submit an annual report to the Congress on the program established under subsection (a). Such report shall—

"(1) describe—

"(A) the industrial assessments resulting from such program, and

"(B) actual or foreseeable economic and technological developments, in the United States and abroad, which have affected or will affect the competitive position of United States industry or of particular United States industry sectors;

"(2) identify and describe with particularity actual or foreseeable developments, in the United States and abroad, which—

"(A) create a significant likelihood of a competitive challenge to, or of substantial dislocation in, an established United States industry,

"(B) present significant opportunities for United States industries to compete in new geographical markets or product markets or to expand their position in established markets, or

"(C) create a significant risk that United States industries will be unable to compete successfully in significant future markets; and

"(3) specify with particularity the industry sectors affected by the developments described in paragraph (2).

"(d)(1) The Secretary of Commerce, in conjunction with the United States Trade Representative, shall establish a special industry sector advisory panel for each industry sector specified in any report submitted under subsection (c) that is of national significance by reason of—

"(A) the employment or capital resources of such sector,

"(B) the impact on national defense of such sector, or

"(C) the importance of such sector as a supplier to, or customer of, other United States industries.

The Secretary of Commerce may establish an industry sector advisory panel for any other industry.

"(2) Each panel established under paragraph (1) shall include representatives of—

"(A) business,

"(B) labor,

"(C) government,

"(D) private sector advisory committees established under section 135, and

"(E) other individuals or representatives of groups whose participation is considered by the Secretary of

Commerce to be important to developing a full understanding of the competitive position of the industry sector involved and the economic importance of such sector to the United States.

"(3) Each panel established under paragraph (1) shall assess the actual or potential dislocation, challenge, or opportunity for the industry sector involved and formulate specific recommendations for responses by business, government, and labor.

"(4) Any discussion held by a panel established under paragraph (1), or any working group operating under the auspices of such a panel, shall not be considered to violate any Federal or State antitrust law.

"(5) Any panel established under paragraph (1), or any working group operating under the auspices of such a panel, shall not be subject to the provisions of the Federal Advisory Committee Act.

"(6) Each panel established under paragraph (1) shall terminate 30 days after making its recommendations, unless the Secretary of Commerce specifically requests that the panel continue in operation.

"(7) If any report that is submitted under subsection (c) after a panel established under paragraph (1) has terminated specifies conditions which had previously required the creation of such panel, the Secretary of Commerce shall again establish such a panel although the Secretary of Commerce may change the membership of such panel.

"(e) Each agency of the United States shall provide to the Secretary of Commerce, upon request, such information as may be necessary to enable the Secretary of Commerce to carry out the purposes of this section.

"(f) The Secretary of Commerce shall enforce appropriate measures to prevent loss or unauthorized disclosure of classified information.".

(b) The table of sections for title I of the Trade Act of 1974 is amended by inserting after the item relating to chapter 8 the following:

"CHAPTER 9—RESEARCH AND MONITORING

"Sec. 186. Establishment of a sectoral research and monitoring capability.".

SEC. 203. ADVISORY SYSTEM.

Subsection (c) of section 135 of the Trade Act of 1974 (19 U.S.C. 2155(c)) is amended by adding at the end thereof the following:

"(4) The committees established under paragraph (1) that represent industry and labor shall—

"(A) hold joint meetings at the call of the respective committee chairmen, and

"(B) meet at the call of the Administering Authority before and during any trade negotiations in order to provide—

"(i) policy advice on such negotiations,

"(ii) technical advice and information on particular products, both domestic and foreign, that are subject to such negotiations, and

"(iii) advice on any other factors relevant to positions of the United States in such trade negotiations.".

SEC. 204. BALANCE OF PAYMENTS AUTHORITY.

(a) The Congress finds that—

(1) under current exchange rate arrangements the dollar has remained significantly overvalued relative to the current account balance for a sustained period of time;

(2) this overvaluation has exacerbated the harm caused by the denial of market access to United States exports and by the actions taken by foreign governments to expand their exports; and

(3) appropriate exchange rate values are necessary if the trade laws of the United States are to function effectively.

(b)(1) Subsection (a) of section 122 of the Trade Act of 1974 (19 U.S.C. 2132(a)) is amended—

(A) by striking out "15 percent ad valorem" in the first sentence and inserting in lieu thereof "a level which the President determines to be necessary to assist in restoring equilibrium in the balance of payments",

(B) by striking out "150 days (unless such period is extended by Act of Congress)" in the first sentence and inserting in lieu thereof "1 year"; and

(C) by striking out the second and third sentences.

(2) Section 122 of the Trade Act of 1974 (19 U.S.C. 2132(a)) is amended by adding at the end thereof the following new subsections:

"(i)(1) The period during which a surcharge may be imposed under subsection (a) may be extended for 1-year periods by enactment of separate Acts of Congress.

"(2) The President may submit to the Congress bills which provide for a 1-year extension of the period during which a surcharge may be imposed under subsection (a). Such a bill shall be subject to the same rules applicable to any implementing bill under section 151.

"(j) For purposes of this section—

"(1)(A) The term 'balance of payments' refers to payments for current transactions (within the meaning of article 30 of the Articles of Agreement of the International Monetary Fund) which are not for the purpose of transferring capital.

"(B) The balance of payments on current account (with imports determined on the basis of the cost-insurance-freight value) as reported by the Secretary of Commerce shall be used to measure payments for current transactions.

"(2)(A) The term 'balance of payments disequilibrium' means a large and serious current account imbalance (either deficit or surplus) that has persisted for more than 18 months.

"(B) A current account imbalance that exceeds 1 percent of the Gross National Product of the United States (as determined by the Secretary of Commerce) shall be treated as a large and serious current account imbalance.".

TITLE III—RELIEF FROM INJURY CAUSED BY IMPORT COMPETITION

SEC. 301. INVESTIGATIONS UNDER SECTION 201 OF TRADE ACT OF 1974.

(a) Chapter 1 of title II of the Trade Act of 1974 (19 U.S.C. 2251, et seq.) is amended—

(1) by striking out "President" each place it appears and inserting in lieu thereof "Administering Authority", and

(2) by striking out "**PRESIDENTIAL**" in the heading of section 202 and inserting "**BY THE ADMINISTERING AUTHORITY**" after the word "**ACTION**".

(b) Paragraph (1) of section 201(a) of the Trade Act of 1974 (19 U.S.C. 2251(a)(1)) is amended by inserting "or to enhance competitiveness" after "alternative uses" in the second sentence.

(c) Subsection (b) of section 201 of the Trade Act of 1974 (19 U.S.C. 2251(b)) is amended—

(1) by striking out "to the domestic industry producing an article like or directly competitive with the imported article" in paragraph (1) and inserting in lieu thereof "to any domestic industry that produces an article like or directly competitive with the imported article or that produces materials, parts, components, or subassemblies irrevocably destined for incorporation in an article like or directly competitive with the imported article.";

(2) by striking out "substantial cause" in paragraphs (1), (2)(C), and (2)(D) and inserting in lieu thereof "cause";

(3) by inserting "domestic production facilities" after "operate" in paragraph (2)(A);

(4) by amending paragraph (2)(B) to read as follows:

"(B) with respect to the threat of serious injury—

"(i) a decline in sales or market share in the domestic industry concerned;

"(ii) a higher and growing inventory in the domestic industry concerned;

"(iii) a downward trend in production, profits, wages, or employment (or increasing underemployment) in the domestic industry concerned;

"(iv) any combination of coordinated government actions, whether carried out severally or jointly, that—

"(I) are bestowed on a specific enterprise, industry, or group thereof the effect of which is to assist the beneficiary to become more competitive in the export of any class or kind of merchandise, and

"(II) causes, or threatens to cause, serious injury to the domestic industry concerned; and

"(v) the extent to which the United States market is the focal point for diversion of exports of the article concerned by reason of restraints on exports of such article to, or on imports of such article into, third country markets; and";

(5) by striking out "may" in paragraph (3)(A) and inserting in lieu thereof "shall";

(6) by amending paragraph (4) to read as follows:

"(4) For purposes of this section, the term 'cause' means a cause which is important. A cause may be important even though other causes, such as a general economic recession, are of equal or greater importance."; and

(7) by adding at the end thereof the following new paragraph:

"(8) For purposes of this section, imports of like or directly competitive articles by domestic producers in an industry shall not be considered a factor indicating the absence of serious injury, or threat thereof, to such industry.".

(d) Paragraph (1) of section 201(d) of the Trade Act of 1974 (19 U.S.C. 2251(d)(1)) is amended—

(1) by striking out "or" at the end of subparagraph (A) and inserting in lieu thereof "and", and

(2) by striking out "remedy" in subparagraph (B) and inserting in lieu thereof "assist in remedying".

SEC. 302. PROVISIONAL RELIEF UPON FINDING OF CRITICAL CIRCUMSTANCES.

Section 201 of the Trade Act of 1974 (19 U.S.C. 2251) is amended by adding at the end thereof the following new subsection:

"(g)(1) If, during the course of an investigation initiated under this title, the Administering Authority finds that critical circumstances exist, the Administering Authority shall impose provisional measures consisting of any actions authorized under section 203(a). Such provisional measures shall remain in effect until the later of—

"(A) the date on which the measures are revoked by the President,

"(B) the date on which the Commission makes a negative determination under subsection (b)(1), or

"(C) the date that is 60 days after the date on which the Commission makes an affirmative determination under subsection (b)(1).

"(2) For purposes of this subsection, critical circumstances exist if a significant increase in imports (absolutely or relatively) over a short period of time has led to circumstances in which a delay in the imposition of relief would cause damage that would be difficult to repair.".

"SEC. 303. CONSULTATIONS WITH FOREIGN GOVERNMENTS.

(a) Subsection (d) of section 201 of the Trade Act of 1974 (19 U.S.C. 2251(d)) is amended by adding at the end thereof the following new paragraph:

"(3) If the Commission makes an affirmative finding or recommendation under this paragraph, the Commission shall also determine (for purposes of section 203(1))—

"(A) whether trade in the article concerned has been affected by any combination of coordinated government actions, carried out severally or jointly, that—

"(i) are bestowed on a specific enterprise, industry, or group thereof, and

"(ii) assist the beneficiary in becoming more competitive in the export of any class or kind of merchandise, and

"(B) the extent to which the United States market is the focal point for diversion of exports of such article by reason of restraints on exports of such article to, or on imports of such article into, third country markets.

Such determinations shall be included in the report submitted under paragraph (1).".

(b) Section 203 of the Trade Act of 1974 (19 U.S.C. 2253) is amended by adding at the end thereof the following new subsection:

"(l) If—

"(1) the Administering Authority determines to provide import relief under section 202(a)(1), and

"(2) the Commission has made an affirmative determination under section 201(d)(3) with respect to an article,

the Administering Authority shall, in addition to the actions taken under section 202(a)(1), consult and negotiate with other countries that produce or consume such article to seek the establishment of a multilateral framework for the maintenance and development of fair, equitable, and nondisruptive patterns of trade in such article.".

SEC. 304. INDUSTRY ASSESSMENT AND COMPETITIVENESS STRATEGY.

(a) Chapter 1 of title II of the Trade Act of 1974 (19 U.S.C. 2251 et seq.) is amended by adding at the end thereof the following new section:

"SEC. 204. INDUSTRY ASSESSMENT AND COMPETITIVENESS STRATEGY.

"(a) After the Commission commences an investigation under section 201(a) on the basis of a petition filed by—

"(1) firms,

"(2) a certified or recognized union, or

"(3) a group of workers,

which represent a significant portion of the industry, the Administering Authority shall establish an advisory group for the industry if such representatives of the industry request, in the petition, that such an advisory group be established.

"(b) Each advisory group established under this section shall consist of—

"(1) individuals appointed by the Administering Authority from among the petitioners who are representative of the firms and of the workers in the domestic industry, and

"(2) officials of the Department of Labor, the Department of Commerce, and the Administering Authority.

"(c)(1) Each advisory group established under this section shall prepare for the industry concerned an assessment of current problems and a strategy to enhance competitiveness that sets forth objectives and specific steps that workers and firms could usefully undertake to improve the ability of the industry to compete or to assist the industry to adjust to new methods of competition.

"(2) Each advisory group established under this section shall include in the assessment and strategy prepared under paragraph (1) a determination of the ability of producers in the industry concerned to generate adequate capital to finance the modernization of plant and equipment or to otherwise enhance competitiveness (including any associated research and development) specified in such assessment and strategy. Such determination shall include an estimate of the overall capital requirements of such industry.

"(3) The assessement and strategy prepared under paragraph (1) shall set forth those actions which may be taken by the appropriate Federal agencies under existing authority, or under new legislation, to assist in achieving the objectives set forth in the assessment and strategy.

"(4) Each advisory group shall submit copies of the assessment and strategy prepared under paragraph (1) to the Commission, the Administering Authority, the Secretary of Labor, and the Secretary of Commerce, within 120 days after the date on which the Commission commences the investigation with respect to the industry under section 201.

"(d) After an assessment and strategy is submitted by an advisory group under subsection (c)(4) and before the close of the period referred to in section 202(b), the Administering Authority, shall seek to obtain, on a confidential basis, information from the individual members of such advisory group regarding—

"(1) how such members intend to act upon the recommended objectives and actions specified in such assessment and strategy, and

"(2) any other actions such members intend to take which will foster the objectives described in subsection (c)(1).

The Administering Authority shall transmit such information to the Commission, the Secretary of Labor, and the Secretary of Commerce on a confidential basis. The Administering Authority shall include in the transmission of such confidential information any other information obtain by the Administering Authority on the capital requirements of the industry referred to in section 201(b)(2)(B).

"(e) The Administering Authority, the Secretary of Commerce, and the Secretary of Labor shall provide such staff, information, personnel, and administrative services and assistance to advisory groups established under this section as such advisory groups may deem necessary to enable such advisory groups to carry out their responsibilities under this section. The Administering Authority may request other executive branch agencies which administer programs that may contribute to enhancing the competitiveness of the domestic industry concerned to assist such advisory groups in carrying out their responsibilities under this section.

"(f)(1) If an assessment and strategy is submitted under subsection, (c), the Administering Authority, the Commission, the Secretary of Labor, and the Secretary of Commerce shall consider such assessment and strategy in making any determination, or taking any action, under the provisions of this title.

"(2) Neither the failure of the representatives of an industry to request the establishment of an advisory group under subsection (a) nor the failure of an advisory group to submit an assessment and strategy under subsection (c) shall be taken into account in making any determination, or taking any action, under the provisions of this title.".

(b)(1) Subsection (a) of section 201 of the Trade Act of 1974 (19 U.S.C. 2251(a)) is amended by adding at the end thereof the following new paragraph:

> "(3) Firms and workers representing a significant portion of an industry may request in the petition that an industry advisory group be established under section 204 for the purpose of preparing an assessment of current problems of the industry and a strategy to enhance competitiveness for the industry.".

(2) Subparagraph (B) of section 201(b)(2) of the Trade Act of 1974 (19 U.S.C. 2251(b)(2)(B)), as amended by section 301(b)(4) of this Act, is amended—

(A) by striking out "and" at the end of subclause (II) of clause (iv), and

(B) by adding at the end thereof the following new clause:

"(vi) in the case of an industry that has developed an assessment and strategy under section 204, the inability of producers in the domestic industry to generate adequate capital to finance the modernization of plants and equipment, or to otherwise enhance competitiveness, including any associated research and development, as set forth in such assessment and strategy for enhanced competitiveness; and ".

(3) Subsection (d) of section 201 of the Trade Act of 1974 (19 U.S.C. 2252(d)) is amended by adding at the end thereof the following new paragraph:

"(4) If an assessment and strategy for the domestic industry is submitted under section 204(c)(2), the Commission shall take into account in developing its recommendations under paragraph (1) the objectives and actions, including the nature and extent of import relief, specified in such assessment and strategy.".

(c)(1) Paragraph (1) of section 202(a) of the Trade Act of 1974 (19 U.S.C. 2252(a)(1)) is amended—

(A) by striking out "and" at the end of subparagraph (A),

(B) by redesignating subparagraph (B) as subparagraph (C), and

(C) by inserting after subparagraph (A) the following new subparagraph:

"(B) shall, if an assessment and strategy has been prepared under section 204, evaluate any objectives and actions specified in such assessment and strategy, and".

(2) Paragraph (3) of section 202(c) of the Trade Act of 1974 (19 U.S.C. 2252(c)(3)) is amended to read as follows:

"(3) the probable effectiveness of import relief as a means of promoting adjustment or modernization in order to improve competitive abilities, the efforts being made or to be implemented by the industry concerned (including actions specified in the assessment and strategy prepared under section 204) to adjust to import competition, and other considerations relative to the position of the industry in the United States economy;".

(d) Section 203 of the Trade Act of 1974 (19 U.S.C. 2253) is amended by adding at the end thereof the following new subsection:

"(m)(1) If the Administering Authority determines to provide import relief under section 202(a)(1) and an assessment of current problems and strategy to enhance competitiveness was submitted under section 204(c) for the industry concerned, the Administering Authority shall publish in the Federal Register, on the same day on which action is taken under subsection (a), notice of the availability to the public of the text of such assessment and strategy and a summary thereof. Upon publication of a summary of the assessment and strategy under the preceding sentence, the Administering Authority shall be entitled to rely upon the actions outlined in such competitive assessment and strategy, and in the confidential information obtained under section 204(d), as one basis for granting relief.

"(2)(A) If a summary of an assessment and strategy is published under paragraph (1), a review committee consisting of the Administering Authority, the Secretary of Labor, and the Secretary of Commerce shall—

"(i) monitor, on a continuing basis, actions taken by the petitioners to improve the competitive position of the industry, including actions specified in any confidential information obtained under section 204(d);

"(ii) make such recommendations for administrative action under existing statutory authority as may be necessary to achieve the objectives specified in such assessment and strategy; and

"(iii) submit to Congress such recommended legislation as the review committee considers necessary or appropriate for the purpose of achieving the objectives specified in such assessment and strategy.

Any proposed legislation submitted under clause (iii) shall be subject to the same rules applicable to an implementing bill under section 151.

"(B) If the review committee described in subparagraph (A) determines that the firms or workers in the domestic industry are not implementing, or are implementing in an unsatisfactory manner—

"(i) the recommended objectives and actions specified in the assessment and strategy published under paragraph (1), or

"(ii) the actions declared in the confidential information obtained under section 204(d),

the review committee shall consult with the advisory group members on an individual or joint basis, as appropriate.

"(C) If, after consultations are held under subparagraph (B) and after taking into account such other relevant information as may be available, the review committee determines that the failure to implement, or failure to implement satisfactorily, the actions described in clause (i) or (ii) of subparagraph (B)—

"(i) is not justified by changed circumstances, and "(ii) has adversely affected overall implementation of the objectives specified in the assessment and strategy published under paragraph (1),

the Administering Authority shall request the Commission to issue a report under section 203(i)(2) within 60 days of the date of such request. After taking such report by the Commission and the determination of the review committee into account, the Administering Authority shall determine whether all import relief provided to the industry under this section should be terminated or modified.".

(e) The table of contents of the Trade Act of 1974 is amended by inserting after the item relating to section 203 the following new item:

"Sec. 204. Industry assessment and competitiveness strategy.".

SEC. 305. IMPORT RELIEF.

(a) Subsection (a) of section 203 of the Trade Act of 1974 (19 U.S.C. 2253(a)) is amended—

(1) by striking out "or" at the end of paragraph (4),

(2) by redesignating paragraph (5) as paragraph (6), and

(3) by inserting after paragraph (4) the following new paragraph:

"(5) consult with petitioners and representatives of workers and firms in the affected industry as to the advisability and desirability of taking appropriate action under section 303 or title VII of the Tariff Act of 1930, or title III of this Act, if, pursuant to any investigation under this title, the Administering Authority has reason to believe that any foreign government or firm is engaged in any action or practice for which relief is available under such section or title; or".

(b) Subsection (j) of section 203 of the Trade Act of 1974 (19 U.S.C. 2253(j)) is amended by inserting "good cause is shown or" after "unless".

TITLE IV—RELIEF FROM INJURIOUS INDUSTRIAL TARGETING AND UNFAIR TRADE PRACTICES

SEC. 401. ENFORCEMENT OF UNITED STATES RIGHTS UNDER TRADE AGREEMENTS AND RESPONSE TO INJURIOUS INDUSTRIAL TARGETING AND OTHER FOREIGN TRADE PRACTICES.

(a)(1) Paragraph (1) of section 301(a) of the Trade Act of 1974 (19 U.S.C. 2411(a)(1)) is amended to read as follows:

"(1) IN GENERAL.—If the Administering Authority determines that action by the United States is appropriate—

"(A) to enforce the rights of the United States under any trade agreement; or

"(B) to respond to any act, policy, or practice of a foreign country or instrumentality that—

"(i) is inconsistent with the provisions of, or otherwise denies benefits to the United States under, any trade agreement,

"(ii) is unjustifiable, unreasonable, or discriminatory and burdens or restricts United States commerce, or

"(iii) constitutes injurious industrial targeting;

the Administering Authority may, to the extent necessary to enforce such rights, or to obtain the elimination of, or offset or otherwise respond to, such foreign act, policy, or practice, take the actions described in subsection (b).".

(2) Paragraph (2) of section 301(a) of the Trade Act of 1974 (19 U.S.C. 2411(a)(2)) is amended by striking out "President" and inserting in lieu thereof "Administering Authority".

(b) Subsection (b) of section 301 of the Trade Act of 1974 (19 U.S.C. 2411(b)) is amended to read as follows:

"(b) AUTHORIZED ACTIONS.—If the Administering Authority determines to take action under subsection (a), the Administering Authority may—

"(1) suspend, withdraw, or prevent the application of benefits of trade agreement concessions to carry out a trade agreement with the foreign country or instrumentality involved;

"(2) direct customs officers to—

"(A) assess duties or impose other import restrictions on the products of, or

"(B) assess fees or impose restrictions on the services of,

such foreign country or instrumentality for such time, in such an amount, and to such a degree as the Administering Authority determines appropriate;

"(3) negotiate agreements (including, but not limited to, orderly marketing agreements) with foreign countries or instrumentalities to fully offset the burden or restrictions on United States commerce;

"(4) submit to the President proposed administrative actions, and if necessary, legislation to implement any other government action which would restore or improve the international competitive position of the industry that has been injured or threatened with injury;

"(5) recommend action by the President under subsection (d) of this section; or

"(6) any combination of the actions described in the preceding paragraphs.".

(c) Subsection (c) of section 301 of the Trade Act of 1974 (19 U.S.C. 2411(c)) is amended—

(1) by striking out "President" each place it appears and inserting in lieu thereof "Administering Authority",

(2) by striking out "United States Trade Representative (hereinafter in this chapter referred to as the 'Trade Representative')" in paragraph (2)(B) and inserting in lieu thereof "Administering Authority", and

(3) by striking out "Trade Representative" in paragraph (3) and inserting in lieu thereof "Administering Authority".

(d) Subsection (d) of section 301 of the Trade Act of 1974 is amended to read as follows:

"(d) Notwithstanding any other provision of law governing any service sector access authorization, the President may, upon recommendation of the Administering Authority—

"(1) restrict, in the manner and to the extent the President deems appropriate, the terms and conditions of any such authorization, or

"(2) deny the issuance of any such authorization, with respect to services of any foreign country or instrumentality referred to in subsection (b).".

(e) Subsection (e) of section 301 of the Trade Act of 1974 (19 U.S.C. 2411(e)) is amended—

(1) by adding at the end thereof the following new paragraph:

"(7) INJURIOUS INDUSTRIAL TARGETING.—The term 'injurious industrial targeting' means any combination of coordinated government actions, whether carried out severally or jointly—

"(A) which are bestowed on a specific enterprise, industry, or group thereof,

"(B) which assist such enterprise, industry, or group to become more competitive in the export of any class or kind of merchandise, and

"(C) which cause, or threaten to cause, material injury (within the meaning of section 305(c)).", and

(2) by striking out "For purposes of this section" and inserting in lieu thereof "For purposes of this title".

(f) Section 302 of the Trade Act of 1974 (19 U.S.C. 2412) is amended—

(1) by striking out "United States Trade Representative (hereinafter in this chapter referred to as the 'Trade Representative')" in subsection (a)(1) and inserting in lieu thereof "Administering Authority",

(2) by striking out "President" in subsection (a)(1) and inserting in lieu thereof "Administering Authority",

(3) by striking out "Trade Representative" each place it appears and inserting in lieu thereof "Administering Authority", and

(4) by striking out "in order to advise the President concerning the exercise of the President's authority under section 301" in subsection (c)(1).

(g) Section 303 of the Trade Act of 1974 (19 U.S.C. 2413) is amended—

(1) by striking out "Trade Representative" each place it appears and inserting in lieu thereof "Administering Authority",

(2) by striking out "section 304" in subsection (b)(1)(B) and inserting in lieu thereof "sections 304 and 305",

(3) by striking out "section 306" in subsection (b)(2)(B) and inserting in lieu thereof "section 310",

(4) by adding at the end thereof the following new subsection:

"(c) DOMESTIC FIRMS AND WORKERS.—The Administering Authority shall consult with representatives of domestic firms and workers that may be affected by any investigation initiated under section 302, including the appropriate advisory committees established under section 135, regarding any determination which is required to be made by the Administering Authority under this title.", and

(5) by striking out "**UPON INITIATION OF INVESTIGATION**" in the heading.

(h)(1) Sections 305 and 306 of the Trade Act of 1974 (19 U.S.C. 2415; 2416) are each amended by striking out "Trade Representative" each place it appears and inserting in lieu thereof "Administering Authority".

(2) Subsection (c) of section 305 of the Trade Act of 1974 (19 U.S.C. 2415(c)) is amended to read as follows:

"(c) CONFIDENTIAL BUSINESS INFORMATION.—

"(1) IN GENERAL.—Upon receipt of a written request for confidential business information obtained by the Administering Authority in connection with any investigation initiated under this title, including any information submitted by foreign governments, the Administering Authority shall make such information available (other than customer names and the identity of market research organizations) under a protective order described in paragraph (5).

"(2) NATIONAL SECURITY.—No information classified for national security reasons shall be made available under this section.

"(3) **Procedures.**—The Administering Authority shall act upon requests for access to confidential business information within 10 days after receiving such request.

"4) **Continuing request.**—A request for confidential business information shall be treated as continuing for the period of the investigation.

"(5) **Protective order.**—The protective order under which confidential business information is made available under this subsection shall contain such requirements as the Administering Authority may prescribe by regulation. The Administering Authority shall prescribe regulations that provide such sanctions for violations of protective orders as the Administering Authority determines to be appropriate, including disbarment from practice before the Administering Authority.".

(i) The table of contents of the Trade Act of 1974 is amended by striking out "upon initiation of investigation" in the item relating to section 303.

SEC. 402. INVESTIGATIONS UNDER TITLE III OF THE TRADE ACT OF 1974.

Section 304 of the Trade Act of 1974 (19 U.S.C. 2414) is amended to read as follows:

"SEC. 304. INVESTIGATIONS BY THE ADMINISTERING AUTHORITY.

"(a) COLLECTION AND VERIFICATION OF INFORMATION.—

"(1) FOREIGN GOVERNMENTS AND ENTERPRISES.—

"(A) QUESTIONNAIRES.—In conducting any investigation initiated under section 302, the Administering Authority shall present detailed questionnaires to the foreign governments and the foreign enterprises involved in such investigation in order to obtain information concerning the allegations contained in the petition.

"(B) VERIFICATION.—The Administering Authority shall verify all information provided by any foreign government or foreign enterprise in the course of any investigation initiated under section 302 which is relied on by the Administering Authority in making any determinations under this title.

"(2) USE OF BEST INFORMATION.—If—

"(A) any foreign government or foreign enterprise fails to provide information requested by the Administering Authority concerning any acts, policies, or practices of such government or enterprise which are under investigation, or

"(B) the information provided by any foreign government enterprise is not sufficient or is otherwise unsatisfactory,

the determinations of the Administering Authority under this title shall be based on the best information otherwise available, which may be the allegations and information contained in the petition.

"(b) PRELIMINARY DETERMINATIONS.—

"(1) IN GENERAL.—By no later than the date that is 5 months after the date on which an investigation is initiated under section 302, the Administering Authority shall make a preliminary determination based upon such investigation as to whether there is reason to believe that—

"(A) the rights of the United States under any trade agreement are not being enforced, or

"(B) any act, policy, or practice of a foreign country or instrumentality—

"(i) is inconsistent with the provisions of any trade agreement or otherwise denies benefits to the United States under any trade agreement,

"(ii) is unjustifiable, unreasonable, or discriminatory and burdens or restricts United States commerce, or "(iii) constitutes injurious industrial targeting.

"(2) PROVISIONAL ACTION.—If the preliminary determination of the Administering Authority under paragraph (1) is affirmative, the Administering Authority may take any action described in paragraph (1), (2), or (3) of section 301(b), or any combination of such actions, pending completion of the investigation.

"(c) FINAL DETERMINATION.—

"(1) IN GENERAL.—By no later than the date that 11 months after the date on which an investigation is initiated under section 302, the Administering Authority shall make a final determination based upon such investigation as to whether any of the circumstances described in subparagraph (A) or (B) of subsection (b)(1) exists.

"(2) ACTIONS AFTER FINAL DETERMINATIONS.—

"(A) AFFIRMATIVE FINAL DETERMINATION.—

"(i) IN GENERAL.—Except as provided in section 306, if the final determination under paragraph (1) is affirmative, the Administering Authority shall, by no later than the date that is 30 days after the date of such final determination, make a determination as to what action, if any, the Administering Authority will take under section 301(a).

"(ii) Consultation.—If the final determination made under paragraph (1) is affirmative, the Administering Authority shall consult with the petitioner, if any, and representatives of the affected domestic firms and workers regarding the action, if any, which is to be taken under section 301(a).

"(iii) Report on failure to take action.—If the final determination made under paragraph (1) is affirmative and the Administering Authority declines to take any action under section 301(a), the Administering Authority shall submit to the Congress a written statement which specifies—

"(I) the reasons why the Administering Authority decided to take no action under section 301(a), and

"(II) the views of representatives of the affected domestic firms and workers regarding such decision.

"(B) NEGATIVE FINAL DETERMINATION.—If—

"(i) the final determination under paragraph (1) is negative, and

"(ii) the Administering Authority took any action under subsection (b)(2),

the Administering Authority shall terminate such action and refund any duties or fees paid by reason of such action.

"(d) PUBLICATION.—Notice of the determinations made under subsections (b)(1) and (c)(1) of this section and of any determination to take action under section 301(a) shall be published in the Federal Register.".

SEC. 403. MANDATORY ACTION IN CASES OF INJURIOUS INDUSTRIAL TARGETING.

(a) Title III of the Trade Act of 1974 is amended by redesignating sections 305 and 306 as sections 309 and 310, respectively, and by inserting after section 304 the following new sections:

"SEC. 305. INVESTIGATIONS OF INJURIOUS INDUSTRIAL TARGETING.

"(a) INVESTIGATIONS BY ADMINISTRATIVE AUTHORITY.—If the Administering Authority makes a preliminary determination under section 304(b)(1) that the circumstances described in section 304(b)(1)(B)(iii) exist, the Administering Authority—

"(1) shall establish an advisory committee composed of—

"(A) representatives of domestic firms and workers in the industries which are affected by such targeting, and

"(B) appropriate Federal officials, and

"(2) by no later than the date on which a final determination is required to be made under section 304(c)(1) with respect to such targeting, shall formulate, in consultation with such advisory committee, proposals which would restore or improve the competitive position of such domestic industries in both domestic and foreign markets.

"(b) INVESTIGATIONS BY INTERNATIONAL TRADE COMMISSION.—

"(1) NOTICE OF INVESTIGATION.—On the day on which the Administering Authority initiates an investigation under section 302 of injurious industrial targeting, the Administering Authority shall submit to the United States International Trade Commission (hereafter in this title referred to as the 'Commission') a copy of—

"(A) if the investigation is initiated under section 302(a), the petition, or

"(B) if the investigation is initiated under section 302(b), a written statement describing the issues under investigation.

"(2) PRELIMINARY DETERMINATION.—By no later than the date that is 60 days after the date on which notice of an investigation is submitted to the Commission under paragraph (1), the Commission shall make a preliminary determination, based upon the best information available to the Commission at the time of the investigation, of whether there is a reasonable indication that—

"(A) an industry in the United States—

"(i) is materially injured, or

"(ii) is threatened with material injury;

or

"(B) the establishment or growth of an industry in the United States is materially retarded;

by reason of sales or likely sales in the United States or other foreign markets of the merchandise which is the subject of such investigation.

"(3) FINAL DETERMINATION.—The Commission shall make a final determination of whether any of the circumstances described in paragraph (2) exist with respect to the merchandise that is the subject of an investigation initiated under section 302 by no later than the date that—

"(A) if an affirmative preliminary determination under section 304(b)(1) was made with respect to such investigation, is 45 days after the date on which an affirmative final determination is made under section 304(c)(1) with respect to such investigation, or

"(B) if the Administering Authority made a negative preliminary determination under section 304(b)(1) with respect to such investigation, is 75 days after the day on which an affirmative final determination is made under section 304(c)(1) with respect to such investigation.

No final determination shall be required under this subsection with respect to an investigation if the final determination under section 304(c)(1) is negative.

"(4) JUDICIAL REVIEW.—Any determination made by the Commission under this section shall be subject to review by the United States Court of International Trade as if such determination were made under either section 703(a) or 705(b) of the Tariff Act of 1930, as the case may be.

"(c) MATERIAL INJURY AND THREAT OF MATERIAL INJURY.—

"(1) MATERIAL INJURY.—

"(A) IN GENERAL.—For purposes of this section, the term 'material injury' means harm which is not inconsequential, immaterial, or unimportant.

"(B) VOLUME AND CONSEQUENT IMPACT.—In making determinations under this section, the Commission shall consider, among other factors—

"(i) the volume of sales of the merchandise which is the subject of the investigation,

"(ii) the effect on sales of that merchandise on prices in the United States or other foreign markets for like products, and

"(iii) the impact of sales of such merchandise on domestic producers of like products.

"(C) EVALUATION OF VOLUME AND PRICE EFFECTS.—For purposes of this section—

"(i) VOLUME.—In evaluating the volume of sales of merchandise, the Commission shall consider whether the volume of sales of the merchandise, or any increase in that volume, either in absolute terms or relative to production or consumption in the United States or other foreign markets, is significant.

"(ii) Price.—In evaluating the effect of sales of the merchandise on prices, the Commission shall consider—

"(I) whether there has been significant price undercutting by the foreign merchandise as compared with the price of like products of the United States, and

"(II) whether the effect of sales of the merchandise otherwise depresses prices to a significant degree or prevents to a significant degree price increases that otherwise would have occurred.

"(iii) Impact on affected industry.—In examining the industry involved in the investigation, the Commission shall evaluate all relevant economic factors which have a bearing on the state of the industry, including, but not limited to—

"(I) actual and potential decline in output, sales, market share, profits, productivity, return on investments, and utilization of capacity, "(II) factors affecting domestic and foreign prices,

"(III) actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital, and investment, and

"(IV) displacement of United States exports of like products in third country markets.

"(2) THREAT OF MATERIAL INJURY.—

"(A) IN GENERAL.—In determining whether an industry in the United States is threatened with material injury, the Commission shall consider, among other relevant economic factors—

"(i) any increase in production capacity or existing unused capacity in foreign countries under investigation that is likely to result in increased exports from such country,

"(ii) any rapid increase in United States market penetration and the likelihood that the penetration will increase to an injurious level,

"(iii) the probability that imports of the merchandise under investigation will enter the United States at prices that will have a depressing or suppressing effect on domestic prices of like products,

"(iv) the probability that exports from foreign countries under investigation will enter third country markets at prices that will have a depressing or suppressing effect on prices for United States exports of like products or will decrease sales of like products of the United States in such third country markets,

"(v) any substantial increase in inventories of the merchandise in the United States or in third country markets,

"(vi) the extent to which the United States market is the focal point for exports of such merchandise by reason of restraints on exports of such article to, or on imports of such article into, third country markets, and

"(vii) any other demonstratable adverse trends that indicate that the importation or sale for importation of such merchandise, or sales of such merchandise in third country markets, will be the cause of actual injury.

"(B) BASIS FOR DETERMINATION.—Any determination by the Commission under this section than an industry in the United States is threatened with material injury shall be made on the basis of the evidence that the threat of material injury is real and that actual injury is imminent. Such a determination may not be made on the basis of mere conjecture or supposition, but can be made on the basis of official statements of intended action by foreign governments.

"(3) STANDARD FOR DETERMINATION.—The presence or absence of any factor which the Commission is required to evaluate under paragraph (1)(C) or (2) shall not necessarily give decisive guidance with respect to the determination of material injury by the Commission.

"SEC. 306. MANDATORY ACTION IN CASES OF INJURIOUS INDUSTRIAL TARGETING.

"(a) PROVISIONAL ACTION.—If—

"(1) the Administering Authority makes a preliminary determination under section 304(b)(1) with respect to an investigation that an act, policy, or practice of a foreign country or instrumentality constitutes injurious industrial targeting, and

"(2) the Commission makes an affirmative preliminary determination under section 305(b)(2) with respect to such investigation,

the Administering Authority shall, pending conclusion of such investigation, take at least one of the actions described in paragraph (1), (2), or (3) of section 301(b), or any combination of such actions, in order to prevent further injury, or threat of injury, from such injurious industrial targeting.

"(b) ACTION IN RESPONSE TO FINAL DETERMINATION.—

"(1) IN GENERAL.—Except as provided in subsection (c), if—

"(A) the Administering Authority makes a final determination under section 304(c)(1) with respect to any investigation that an act, policy, or practice of a foreign country or instrumentality constitutes injurious industrial targeting, and

"(B) the Commission makes an affirmative final determination under section 305(b)(3) with respect to the merchandise that is the subject of such investigation,

the Administering Authority shall take at least one of the actions described in section 301(b) in order to fully offset the material injury, or threat of material injury, from such injurious industrial targeting.

"(2) PROPOSALS.—

"(A) IN GENERAL.—If the requirements of subparagraphs (A) and (B) of paragraph (1) are met, the Administering Authority shall submit to the President—

"(i) any proposed administrative action, and

"(ii) any proposed legislation,

which the Administering Authority determines is necessary to restore or improve the competitive position of any industry that is materially injured, or threatened with material injury, by the injurious industrial targeting.

"(B) SPECIAL CONSIDERATION OF PROPOSED LEGISLATION.—The President may submit to the Congress a bill that consists of the legislative proposal described in subparagraph (A)(ii). Such bill shall be subject to the same rules applicable to an implementing bill under section 151, except that in applying paragraphs (1) an (2) of section 151(e) with respect to such bill "15th day" shall be substituted for "45th day".

"(3) REPORT TO CONGRESS.—If the requirements of subparagraphs (A) and (B) of paragraph (1) are met, the Administering Authority shall submit a written statement to the Congress which specified the actions that the Administering Authority will take under paragraph (1) to offset the material injury, or threat of material injury, from the injurious industrial targeting.

"(c) SETTLEMENT AGREEMENTS.—In lieu of taking action under subsection (b)(1), the Administering Authority may enter into an agreement with the foreign country or instrumentality involved if—

"(1) such agreement completely eliminates the material injury, or threat of material injury, from the injurious industrial targeting, and

"(2) in the case of an investigation initiated under section 302(a), such agreement is approved by the petitioner.

"(d) PUBLICATION.—Notice of any action taken by the Administering Authority under this section, and of any agreements entered into under subsection (c), shall be published in the Federal Register.

"SEC. 307. TERMINATION AND COMPENSATION UPON GATT DISAPPROVAL.

"If the contracting parties to the General Agreement on Tariffs and Trade disapprove of any action taken by the Administering Authority under section 301 or 306, the Administering Authority may take such other action as the Administering Authority determines appropriate to compensate any foreign country or instrumentality that is adversely affected by such action, including, but not limited to—

"(1) modification or termination of the action taken under section 301 or 306, or

"(2) modification or continuance of any existing duty or any duty-free or excise treatment.

"SEC. 308. REMEDIES UNDER TARIFF ACT OF 1930.

"If, in the course of an investigation conducted under this title, the Administering Authority has reason to believe that a foreign government is engaged in any action or practice for which relief is available under section 303 or title VII of the Tariff Act of 1930, the Administering Authority shall consult with the petitioner, if any, and the representatives of the domestic firms and workers that may be affected by such action or practice regarding the advisability and desirability of taking action under the appropriate provisions of section 303 or title VII of the Tariff Act of 1930.".

(b) The Table of contents of the Trade Act of 1974 is amended by striking out the items relating to sections 304, 305, and 306 and inserting in lieu thereof the following:

"Sec. 304. Investigations by the Administering Authority.
"Sec. 305. Investigations of injurious industrial targeting.
"Sec. 306. Mandatory action in cases of injurious industrial targeting.
"Sec. 307. Termination and compensation upon GATT disapproval.
"Sec. 308. Remedies under Tariff Act of 1930.
"Sec. 309. Requests for information.
"Sec. 310. Administration.".

TITLE V—COUNTERVAILING AND ANTIDUMPING DUTIES

SEC. 501. LIMITATIONS ON ACCEPTANCE OF COUNTRY UNDER THE AGREEMENT.

Section 701 of the Tariff Act of 1930 (19 U.S.C. 1671) is amended—

(1) by inserting "which meets the requirements of subsection (c) and" after "means of country" in subsection (b),

(2) by redesignating subsection (c) as subsection (e), and

(3) by inserting after subsection (b) the following new subsections:

"(c) ADDITIONAL REQUIREMENTS.—

"(1) IN GENERAL.—A country meets the requirements of this subsection if such country has made a commitment under the General Agreement on Tariffs and Trade to—

"(A) eliminate its export subsidies within 1 year (or within 5 years in the case of least developed countries),

"(B) not increase, extend, or add export subsidies, and

"(C) eliminate immediately export subsidies on those products in which such country is competitive.

"(2) For the purpose of determining the competitiveness of merchandise, the Commission, at the request of the administering authority, shall conduct an investigation of whether the merchandise is already competitive in the United States market and whether the merchandise would be competitive in the absence of export subsidies. The Commission shall submit a final report on such investigation to the administering authority by no later than the date is 60 days after the date on which the administering authority requested such investigation.

"(d) REVIEW OF COMPLIANCE; TERMINATION OF STATUS.—

"(1) REVIEW.—The administering authority shall review the current status of, and compliance with, the agreements described in subsection (b) or (c) at least once during each 12-month period following the date on which the agreement becomes effective.

"(2) PUBLICATION OF DETERMINATIONS.—The administering authority shall determine whether each foreign country has honored each term of the agreements described in subsection (b) or (c) that such country entered into and shall publish such determinations in the Federal Register by no later than the date that is 45 days after the anniversary of the effective date of the agreement.

"(3) TERMINATION OF STATUS; SUSPENSION OF LIQUIDATION.—

"(A) IN GENERAL.—If the administering authority determines that a foreign country has failed to honor any term of an agreement described in subsection (b) or (c) that such country entered into—

"(i) such country shall cease to be treated as a country under the Agreement for purposes of this Act on and after the day that is 30 days after the date on which such determination is published in the Federal Register, and

"(ii) the administering authority shall—

"(I) order the suspension of liquidation of all entries, and withdrawals from warehouse, for consumption after such day of all merchandise of such country that has, at any time, been the subject of an affirmative determination under section 705(a), and

"(II) initiate investigations under section 303 with respect to such merchandise on such day.

"(B) **Negative preliminary determination.**—If the preliminary determination of the administering authority described in section 703(b) in an investigation conducted under section 303 is negative, the administering authority shall terminate on the day of such preliminary determination any suspension of liquidation ordered under subparagraph (A)(ii)(I) with respect to the merchandise that is involved in such investigation.

SEC. 502. NATURAL RESOURCE SUBSIDIES.

(a) **In General.**—Paragraph (5) of section 771 of the Tariff Act of 1930 (19 U.S.C. 1677) is amended to read as follows:

"(5) **Subsidy.**—The term 'subsidy' means a bounty or grant (within the meaning of section 303 of this Act) and includes, but is not limited to—

"(A) any export subsidy described in annex A to the Agreement (relating to illustrative list of export subsidies),

"(B) any natural resource subsidy, and

"(C) the following domestic subsidies, if provided or required by government action to a specific enterprise or industry, or group of enterprises or industries, whether publicly or privately owned, and whether paid or bestowed directly or indirectly on the manufacture, production, or export of any class or kind of merchandise:

"(i) The provision of capital, loans, or loan guarantees on terms inconsistent with commercial considerations.

"(ii) The provision of goods or services at preferential rates.

"(iii) The grant of funds or forgiveness of debt to cover operating losses sustained by a specific industry.

"(iv) The assumption of any costs or expenses of manufacture, production, or distribution.".

(b) DEFINITIONS.—Section 771 of the Trade Act of 1974 (19 U.S.C. 1677) is amended by adding at the end thereof the following new paragraphs:

"(18) NATURAL RESOURCE SUBSIDY.—

"(A) EXISTENCE OF SUBSIDY.—A natural resource subsidy exists if—

"(i) a natural resource product is provided or sold by a government-regulated or government-controlled entity within a country (hereinafter in this paragraph referred to as the 'exporting country'), for use (directly or indirectly) in the manufacture or production in the exporting country of any class or kind of merchandise which is the subject of an investigation under subtitle A, at a domestic price that—

"(I) is lower than the fair market value of the natural resource product in the exporting country, and

"(II) is not freely available to United States producers for purchase of that product for export to the United States, and

"(ii) such natural resource product would, if sold at the fair market value, constitute a significant portion of the total cost of the manufacture or production of such merchandise.

"(B) AMOUNT OF NATURAL RESOURCE SUBSIDY.—The amount of a natural resource subsidy is the difference between the domestic price of the natural resource product and the fair market value of that product.

"(C) **Fair market value.**—For purposes of this paragraph, the term 'fair market value' means the price that a willing buyer would pay a willing seller for a natural resource product in an arms-length transaction in the absence of government regulation.

"(D) **Determination of fair market value.**—In determining the fair market value for purposes of this paragraph, the Administering Authority shall take into account—

"(i) except as provided in subparagraph (E), the export price of the natural resource product,

"(ii) the prices at which the product is generally available in world markets,

"(iii) the current market clearing price at which the product can be sold competitively by the exporting country in the markets of other countries (including the United States) that are non-State-controlled-economy-country markets,

"(iv) the effects on the current market clearing price of—

"(I) the availability to the exporting country of markets described in clause (iii), or

"(II) the lack of access of the exporting country to such markets,

that are due to such factors as costs incident to transportation and handling of the product, and

"(v) the extent, if any, to which the exporting country enjoys a comparative advantage in relation to other sellers (for example, any cost savings resulting from such factors as the availability of abundant supplies or lower production costs).

"(E) EXPORT PRICE NOT TO BE CONSIDERED.—The export price of the natural resource product shall not be taken into account in determining the fair market value of such product for purposes of this paragraph if—

"(i) there are no exports of such product, or

"(ii) the export price of such product is distorted by being either significantly higher or lower than market prices in the relevant market by reason of quotas or other government manipulation.

"(F) TRANSPORTATION AND HANDLING EXPENSES.—In determining domestic price, export price, and fair market value for purposes of this paragraph, the Administering Authority shall not include costs incident to transportation and handling required to move the natural resource product from the point of production to the respective domestic or foreign destination. If domestic price, export price, or fair market value is available only on a delivered basis and actual transportation and handling costs are not readily calculable, the Administering Authority shall deduct from such prices or value a reasonable estimate of such costs.".

SEC. 503. FOREIGN MARKET VALUE.

(a) Section 773(b) of the Tariff Act of 1930 (19 U.S.C. 1677b(b)) is amended by striking out the second sentence and inserting in lieu thereof the following: "The Administering Authority shall include in calculating the cost of producing the merchandise the value of any benefit the producer or manufacturer has received from government research and development programs (including programs supporting or coordinating cooperative research and development among producers or manufacturers). The value of such a benefit shall be considered the research and development expense the producer or manufacturer would have incurred if the producer or manufacturer had done the research and development alone. If the Administering Authority determines that sales made at less than cost of production have been made over an extended period of time and in substantial quantities, such sales shall be disregarded in the determination of foreign market value.".

(b) Section 773 of the Tariff Act of 1930 (19 U.S.C. 1677b) is amended by adding at the end thereof the following new subsection:

"(h) SPECIAL RULES FOR DETERMINING COST OF PRODUCTION AND CONSTRUCTED VALUE.—

"( ) IN GENERAL.—Before the Administering Authority—

"(A) makes a determination under subsection (b) that sales of the merchandise in the home market are at prices which represent less than the cost of producing the merchandise, or

"(B) determines constructed value under subsection (e),

the Administering Authority shall determine whether imports of the merchandise into the home market have been unreasonably restrained. If such determination is affirmative, the Administering Authority shall base the determinations described in subparagraphs (A) and (B) on a per-unit cost rate of capacity utilization appropriately adjusted to reflect the level of home market sales that would occur in the absence of the unreasonable restraints found to exist.".

SEC. 504. THREAT OF INJURY.

Clause (i) of section 771(7)(F) of the Tariff Act of 1930 (19 U.S.C. 1677(7)(F)(i)) is amended—

(1) by striking out "and" at the end of subclause (VII),

(2) by striking out the period at the end of subclause (VIII) and inserting in lieu thereof a comma, and

(3) by inserting the following new subclause after subclause (VIII):

"(IX) any combination of coordinated government actions, whether carried out severally or jointly, that are bestowed on a specific enterprise, industry, or group thereof the effect of which is to assist the beneficiary to become more competitive in the export of any class or kind of merchandise and to cause, or threaten to cause, material injury to the United States; and

"(X) the extent to which the United States is the focal point for exports of the merchandise by reason of restraints on exports of the merchandise to, or on imports of the merchandise into, third country markets.".

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UNITED STATES DEPARTMENT OF COMMERCE
The Under Secretary for International Trade
Washington, D.C. 20230

Dear Mr. Chairman:

We understand that the Subcommittee on Commerce, Transportation, and Tourism will mark-up legislation on November 20, 1985, which includes elements from H.R. 1950, the Trade Law Modernization Act, and H.R. 2809, the Comprehensive Trade Law Reform Act of 1985. We would like to provide you with our comments on these bills which make comprehensive changes to United States trade laws.

We appreciate your effort to identify areas in which the trade laws can be strengthened to provide quicker and surer relief to U.S. industries harmed by unfair import competition. After reviewing the legislation in light of our international obligations, however, we believe that many of its provisions are not consistent with those obligations. In addition, we believe that enactment of this legislation would send a strong protectionist signal to our trading partners just as we are making real progress toward the initiation of a new round of trade talks intended to remove barriers to free and fair trade -- not erect them. If enacted, it would invite retaliation which would adversely affect the United States economy. We are therefore opposed to enactment of this legislation.

The Administration is especially concerned that the provisions of the legislation dealing with the antidumping and countervailing duty ("AD," "CVD") laws are not permissible under the GATT and the Antidumping and Subsidies Codes and, if enacted, will jeopardize U.S. exports. We would also note that the AD and CVD statutes underwent major revision last year in the Trade and Tariff Act of 1984. Most of those changes were aimed at making it easier for U.S. industries to obtain relief from unfairly traded injurious imports. Those changes have to be given time to work before new revisions are made. Moreover, Commerce is currently carrying out 72 CVD and AD investigations. In fiscal year 1985 alone, 133 cases were initiated. The sheer magnitude of the case load demonstrates that U.S. producers believe that these laws work. With the possible exception of dealing with imports from non-market economies, these laws are effective and do not need modifying.

We also strongly object to several of the changes to the trade remedy statutes (sections 201 and 301 of the Trade Act of 1974), such as the transfer of authority away from the President, the reduced injury standard for "escape clause" investigations, the addition of an injury test for section 301 investigations into targeting practices, and the attempt to shift the focus of section 301 from elimination of restrictions on trade towards the provision of import relief. In addition, we strongly oppose several provisions in the legislation relating to coordinated industrial planning by the Government, industry, and labor because they attempt to substitute government planning for free market forces.

A summary of our major objections to the bills is enclosed.

The Administration remains committed to a policy of free but fair trade. The President's September 23rd statement on trade policy outlines a series of forceful actions which the Administration will take to ensure better access to foreign markets and fairer conditions for trade, including the unprecedented and aggressive use of the section 301 authority to protect U.S. interests and the establishment of a strike force, chaired by Secretary Baldrige, to identify and counter unfair trade practices. We will also work with the Congress to draft improvements to the U.S. trade laws to promote free and fair trade, including improvements with respect to protection of intellectual property rights and trade with nonmarket economy countries. The actions outlined by the Administration will, we believe, achieve the goals of H.R. 1950 and H.R. 2309, but in a manner which is consistent with our international obligations.

The Office of Management and Budget advises us that it has no objection to the submission of this report to the Congress and that enactment of H.R. 1950 and H.R. 2809 would not be in accord with the program of the President.

Sincerely,

Bruce Smart

Enclosure

The Honorable John D. Dingell
Chairman, Committee on Energy
and Commerce
House of Representatives
Washington, D.C. 20515

ADMINISTRATION VIEWS ON SELECTED PROVISIONS OF H.R. 1950 AND H.R. 2809

I. Amendments to the Antidumping and Countervailing Duty Statutes

A number of the amendments proposed in H.R. 1950 and H.R. 2809 affect the antidumping and countervailing duty ("AD," "CVD") statutes. These amendments attempt to broaden the scope of these laws and to simplify requirements to provide for quicker relief. Many of these amendments are not consistent with our international obligations or create practical problems which would render the proposed solutions unworkable.

1. Provisional and Retroactive Relief. Several of the amendments in H.R. 1950 and H.R. 2809 would eliminate the requirement that the International Trade Commission ("ITC") make a preliminary or final injury determination before the imposition of provisional relief (the suspension of liquidation of merchandise and the posting of bond), or the retroactive assessment of duties.*

- These amendments violate our obligations under the Antidumping and Subsidies Codes. Article 5 of the Subsidies Code and Article 10 of the Antidumping Code authorize signatories to take provisional measures only after a "preliminary affirmative finding" has been made that there is "sufficient evidence of injury." Further, the Codes provide for retroactive assessment of duties to counter surges of imports, but only after a determination has been made that the injury caused by the surge is difficult to repair and retroactive assessment is necessary to prevent the injury from recurring.

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*Section 501 of H.R. 1950 would amend section 701(d)(3)(A)(ii) of the Tariff Act of 1930 ("Tariff Act") to require suspension of liquidation of merchandise previously subject to an affirmative CVD determination if a "country under the Agreement" fails to meet certain "additional requirements" to eliminate export subsidies.

Section 102 of H.R. 2809 eliminates the requirement that the ITC make a determination with respect to whether injury is caused by a surge of imports and with respect to the extent that a retroactive assessment of duties is necessary to prevent the injury from recurring.

Section 103 of H.R. 2809 amends section 703 of the Tariff Act of 1930 to eliminate the requirement for a preliminary injury determination in CVD cases involving persistent dumping or subsidization.

- The United States formally complained when Australia applied provisional measures against U.S. exports without first applying the injury test. As a result of pressure from the U.S. and other Code signatories, Australia amended its law. The United States should not itself violate the GATT in this manner.

- Elimination of the preliminary determination of injury by the ITC would force the Department to undertake the expense of carrying out investigations which have no merit because of the absence of injury to the petitioner.

2. Limitation on Acceptance of "Country under the Agreement." Section 501 of H.R. 1950 and section 101 of H.R. 2809 amend section 701 of the Tariff Act to impose limits on whether a country may be deemed a "country under the Agreement" and entitled to receive the injury test for purposes of countervailing duty investigations. Several of the requirements set out in this section go far beyond what nations have agreed to in the GATT and the Subsidies Code:

- Section 701(c) as amended, which would require a GATT member to eliminate export subsidies on primary products as well as non-primary products, violates Articles 9 and 10 of the Subsidies Code, which specifically allow export subsidies on primary products as long as these subsidies do not result in a country having more than an equitable share of world export trade in the subsidized product. Since the United States also maintains a system of export subsidies for primary products, we could not satisfy these requirements and would invite retaliation by our trading partners.

- The requirement in section 701(c)(1)(C) that a country eliminate export subsidies immediately on "competitive" products is unworkable. Until the ITC ruled on virtually every product exported to the United States from a prospective GATT signatory, that country could not know for which products the United States would require immediate elimination of export subsidies. The ITC would be swamped with requests that would require sophisticated and complex investigations. The ITC could not complete such an investigation in 60 days.

- The requirement added to section 701(d) of the Act, that the United States terminate the injury test for countries which do not meet the additional requirements imposed by the legislation, is inconsistent with our obligations under Article XXIII of the GATT and Articles 12 and 13 of the Subsidies Code dealing with consultations, conciliation, dispute settlement and authorized countermeasures. Although it may be appropriate for the United States to press for changes to these mechanisms in the new trade round to make them more effective, we cannot ignore our international obligations and take unilateral action in contravention of their requirements.

3. Natural Resource Subsidies. Section 502 of H.R. 1950 amends section 771(5) to broaden the definition of subsidy to reach "natural resource subsidies." Under this section, a natural resource subsidy would exist whenever a government sells a natural resource product to domestic industries at a price below the fair market value of the product.

We strongly oppose these amendments for the following reasons:

° They represent a major departure from longstanding U.S. and international practice regarding the definition of a subsidy. By attempting to countervail programs generally available in a foreign country which do not provide benefits to a specific industry or group of industries, the bill represents a fundamental departure from the internationally accepted definition of subsidy.

° They would be subject to GATT challenge and would almost certainly result in authorization to retaliate against U.S. exports.

° They would expose U.S. industries to countervailing duties elsewhere if our trading partners adopted a similar definition.

4. Foreign Market Value. a. Research and Development. Subsection (a) of section 503 of H.R 1950 amends section 773(b) of the Tariff Act relating to calculation of the "cost of production" in dumping cases to require Commerce to include the value of any benefit received by the exporter from a government research and development ("R & D") program, including "programs supporting or coordinating" R&D among producers. This subsection provides further that the value of such benefit shall be considered the R&D expense the producer would have incurred if the producer had done the R&D alone.

° To the extent that R&D assistance is provided by a government to a specific industry and the results of the R&D are used only by those firms, it is currently covered under the CVD law and a remedy is available to competing U.S. producers.

- To the extent that this subsection requires Commerce to calculate R&D costs jointly borne by producers as the amount that an individual producer would have incurred if it had done the R&D alone, it contradicts the central purpose of making cost of production calculations, which is to determine whether the producer under investigation is selling below its costs. If the investigation were to cover more than one participant in the R&D venture, this provision would also lead to a double-counting of the R&D expenditures in the AD proceeding.
- If our trading partners enacted mirror legislation, U.S. exports of producers participating in joint ventures could be faced with antidumping duties as a result of a corresponding provision in foreign law which in effect penalizes a producer for taking advantage of efficiencies inherent in performing R&D through joint ventures.

b. Unreasonable Import Restraints. Subsection (b) of section 503 requires Commerce to attempt to calculate the cost effects on the price of merchandise within the home market of a foreign country resulting from the imposition of "unreasonable" restraints on imports. This change is apparently intended to address a situation where the cost of producing a product is lower than it would otherwise be because of the imposition of unreasonable import restraints which protect the producer from competition and enable it to achieve economies of scale. In such cases, Commerce would be required to adjust the "cost of production" upward on the basis of its estimate of the "per unit cost rate of capacity utilization" which reflects the level of home market sale that would occur in the absence of the unreasonable restraints.

- Determinations made under this provision undoubtedly would face frequent and time-consuming judicial challenges. The provision requires highly speculative assumptions concerning the elasticities of world supply and home market demand, as well as the degree to which the producer's per-unit costs would increase or decrease at a higher production level. In addition, Commerce would need to conduct a separate investigation into the different types of import restraints imposed and the degree to which they are "unreasonable."
- The provision would invite foreign retaliation against U.S. exports through either mirror legislation or GATT challenge.
- The provision is unnecessary since U.S. law already provides ample authority to deal with unreasonable import barriers.

5. Threat of Injury and Export Targeting Section 504 of H.R. 1950 adds criteria to the definition of "threat of injury" to require the ITC to consider whether there was a "combination of coordinated government actions...to assist the beneficiary to become more competitive in the export of any class or kind of merchandise."

- The Administration has expressed its views in reports on targeting prepared by the Departments of Commerce and Labor and the United States Trade Representative ("USTR") pursuant to section 625 of the Trade and Tariff Act of 1984. To the extent that a "combination of coordinated government actions" (i.e., targeting) includes the use of countervailable subsidies, such as preferential financing, there is no need to amend the law since it already requires the ITC to consider these practices in making a determination of injury. To the extent this amendment seeks to reach targeting practices which do not employ countervailable subsidies, however, it is inconsistent with our international obligations. We believe section 301 of the Trade Act of 1974, in its present form, is a more appropriate mechanism to deal with these problems.

6. Industry and Labor Associations Producing Component Parts Treated as Interested Parties. Section 107 of H.R. 2809 would allow U.S. producers of components, major parts, assemblies or sub-assemblies to file AD and CVD cases against the final product containing those components.

- This provision clearly contravenes the Antidumping and Subsidies Codes, which require that cases be brought by producers of the like product. It is similar to the Wine Equity provision passed as part of the Trade and Tariff Act of 1984 which allowed grape growers to bring cases against wine imports. As soon as that provision was enacted, the law was challenged by our trading partners under the Subsidies Code.

7. Diversionary Dumping. Section 108 of H.R. 2809 requires DOC to determine whether a product under investigation incorporates inputs which have been the subject of a previous U.S. antidumping investigation. This provision is similar to last year's downstream dumping proposal. Though certain changes have been made to the proposal, we continue to oppose this concept.

- Dumping investigations measure whether a foreign producer is price discriminating or selling below its cost of production. That producer controls its own pricing practices and, consequently, controls whether it will engage in dumping in the United States. Such control is absent under the proposed change. The exporting firm would be dependent on the pricing behavior of other firms. It could not avoid dumping by changing its own pricing behavior. Moreover, it frequently would not know whether its suppliers have priced the input at market price or at the cost of production, and, as a result, would not know until after the fact whether it had inadvertently incurred dumping liability.

- The measure of the value of the input set out in the bill, which would be the fair value calculated in a previous case which investigated dumping of the input into the U.S., is an arbitrary measure of fair value for consumers in other countries. First, the value calculated in the previous case will have been based on information which is not likely to be current by the time the allegation of diversionary dumping is made. Second, in calculating the fair value in the previous case, Commerce will have made adjustments to the price to reflect the terms and conditions of the sale and the type of merchandise sold in the United States--adjustments which are not appropriate for purposes of determining the fair value of the input to the foreign producer incorporating the input into the product under investigation.

- Much of the information used to calculate fair value is proprietary. The producers of the input are not likely to agree to release of that information to foreign and U.S. producers of the product using that input. They have no incentive to cooperate and failure to cooperate would not lead to the imposition of sanctions against them. Without such cooperation, an innocent purchaser of the input will unfairly face the virtual certainty of having dumping duties assessed against its product.

8. Other provisions We have other objections too numerous to discuss in this document. We would be pleased to meet with your staff to go over these other problems.

II. Amendments regarding Trade Policy

1. Transfer of Certain Statutory Authorities. H.R. 1950 would transfer from the President to the USTR significant authority under the Trade Act of 1974 concerning unfair trading practices (title III), the Generalized System of Preferences (title V), and section 201 ("escape clause"). In addition, H.R. 1950 would transfer to the Secretary of Commerce authority under section 406 of the 1974 Trade Act (market disruption with respect to an article produced by a Communist country).

- We believe that authority within the Executive Branch is more appropriately placed with the President, as under current law, in light of the significant role and sometimes divergent interests that many agencies have in these matters. The President is best situated to weigh the various economic interests of the United States and to exercise the discretion granted to him by current law under these provisions.

2. National Trade Policy and Negotiating Objectives. Section 101 of H.R. 1950 sets forth certain national trade policy objectives "that shall guide the conduct of United States trade policy and domestic economic policy." Section 103 sets forth several specific trade negotiating objectives. While as a general matter we can support these objectives, we would point out that --

- It is not the policy of this Administration to "[maximize] the degree of export financial support if necessary to offset the support provided by foreign governments to their supporters." Although the President has now authorized the establishment of a $300 million fund to combat the entrenched mixed-credit policies of certain of our trading partners, the Administration has not changed its fundamental view that mixed credits distort trade flows and result chiefly in increased costs to all exporting nations - with no assurance of net benefits.

- The negotiating objectives regarding exchange rate stability and a new multilateral exchange rate and payment system appear to go well beyond the extent and type of monetary reform which the Administration believes to be warranted.

3. Procedure for Developing Trade Agenda. Section 102 of H.R. 1950 provides for the submission of a report to the Congress each year by the USTR containing a statement of the actions the President proposes to take to achieve the national trade policy objectives during the coming year. The Administration proposals would then be the subject of a "formal" vote by the Senate Finance and House Ways and Means Committees, prior to these Committees' conveying their views on the proposals to the USTR.

- These provisions are highly objectionable in that they preclude the degree of flexibility and confidentiality necessary to carry out a credible trade policy. These provisions also provide for a means of Congressional involvement which is both inappropriate and counterproductive. We fully recognize the value of consulting with the Congress on matters of trade policy administration; however, we do not believe that these provisions provide for mutually beneficial interaction.

4. Negotiating Authority: Government Procurement. Section 104 of H.R. 1950 provides the President with special negotiating authority in the area of government procurement. In addition, section 104 contains provisions, similar to section 301 of the 1974 Trade Act, authorizing the USTR to retaliate against discriminatory government procurement practices; and provides specific reciprocal retaliatory authority for certain sectors.

We are opposed to these provisions for following reasons:

- First, the negotiating authority provided by section 104 is not necessary. The President is committed to, and intends to obtain, fair and equitable market opportunities through consultations and negotiations with our trading partners.

- Second, while the Administration is committed to eliminating unfair trading practices among our trading partners, we will oppose legislation which is sectoral in nature, would have the principal effect of closing U.S. markets without adequate opportunity for negotiations with our trading partners, and which limits Presidential flexibility to negotiate trade agreements based on the principle of comparative advantage. Since these provisions are clearly intended to apply to the telecommunications sector, we feel it necessary to advise the Committee that the Administration would not support a telecommunications bill that is inconsistent with these concerns. Although we recognize that the telecommunications sector is of special concern, we will carefully scrutinize any bill to ensure that its enactment would be in the national interest.

- Third, the U.S. Government imposes Buy America restrictions on purchases not covered by the GATT Government Procurement Code. This practice is permitted under the GATT and the Code. We believe that any retaliatory measures taken against discriminatory foreign government procurement practices will likely result in our trading partners retaliating in a similar manner against U.S. suppliers.

5. Sectoral Research and Monitoring. Sections 201 and 203 of H.R. 1950 would establish, within the Department of Commerce, a program to "assess and evaluate the industrial and trade policies of other countries and the effects of such policies on United States industry, trade and employment (including the effect on the export competitiveness of specific enterprises, industries, or groups thereof)." The program would include the preparation of an annual report containing the Secretary's assessment, noting

significant opportunities for new markets, and identifying areas where there is significant risk that United States industries will be unable to compete successfully. Under section 202, the Secretary of Commerce would establish special industry sector advisory panels, consisting of representatives of business, labor, and government, as well as members of the sectoral advisory committees established under section 135 of the 1974 Trade Act, to assist him in carrying out the program and preparing recommendations.

We strongly oppose these provisions:

- The current system of advisory committees established pursuant to section 135 of the 1974 Trade Act is working extremely well and is providing the President with extensive and valuable advice in the areas addressed by these provisions of the Act. Furthermore, these provisions, similar to others recently considered by Congress, are "industrial policy" provisions often opposed by this Administration in the past. We continue to oppose such provisions, which imply a role on the part of the Federal government in making choices that we believe should be made by free market forces.

6. Balance of Payments Authority. Section 204 of H.R. 1950 amends section 122 of the Trade Act of 1974 to remove the 15% cap on import surcharges imposed pursuant thereto; to remove the present 150-day limitation on such surcharges (providing instead that any surcharge shall be imposed for a period of one year, and may be renewed annually by legislation); and to define the terms "balance of payments" and "balance of payments disequilibrium." We are strongly opposed to these provisions.

- Extending balance-of-payments relief to a period of a year (with the possibility of indefinite renewals) amounts to little more than an across-the-board tariff increase, to which the Administration is strongly opposed. Such an increase would almost certainly be challenged by our trading partners under the GATT.

- Furthermore, the definitions adopted in section 204 remove any flexibility the President may now have under section 122. Under the definition provided in the bill, a balance-of-payments disequilibrium would have been in effect during each of the last three years, and the President would have been compelled to impose a surcharge. This limitation on the President's flexibility under section 122 is insupportable.

- The bill's focus on the current account balance, to the exclusion of the U.S. capital account, is incorrect and ignores a vital element of our overall balance of payments situation.

III. Amendments to the Section 201 Authority of the Trade Act of 1974.

Title III of H.R. 1950 and Title II of H.R. 2809 make numerous amendments to the "escape clause" authority of section 201 of the Trade Act of 1974, including proposals to: (1) strengthen the role of the administering authority (section 301(a) of H.R. 1950); (2) reduce the causation requirement from a "substantial cause of serious injury" to "a cause of serious injury" (section 301(c)); and (3) add an additional criterion to the "threat of injury" standard to address export targeting (section 301(c)).

We oppose these changes for the following reasons:

- Authority for conducting section 201 investigations within the Executive Branch is more appropriately placed with the President, as under current law, in light of the significant role that diverse agencies have in these cases. The President is in the best position to determine the national economic interest, as well as to resolve interagency differences.

- The proposal to weaken the injury test from "substantial cause of serious injury" to "a cause" would allow import relief to be extended under section 201 even where imports are not a substantial cause of injury and other causes are of equal or greater importance, such as a "general economic recession." Inasmuch as a grant of relief under section 201 requires offsetting compensation to foreign suppliers at the expense of other U.S. industries, we believe that the current standard should be retained to restrict this extraordinary relief to its original purpose, namely to provide an industry with breathing room to respond to import competition which is causing the distress. Further, this lower standard is not consistent with our understanding of how Article XIX of the GATT is to be interpreted.

- The proposal to require the International Trade Commission to investigate whether export targeting by foreign governments is causing injury is unwise and unnecessary. We believe section 301 of the Trade Act of 1974 provides the Executive Branch with adequate authority to investigate questions of export targeting. Such investigations require government-to-government consultations and this authority must remain with the Executive, especially in light of the fact that there is no international consensus on what constitutes export targeting and the degree to which it is prohibited by international rules.

- Finally, we are strongly opposed to the provisions relating to the use of advisory groups to formulate "industry assessments" and "competitiveness strategies" under section 201. These proposals would convert section 201 into an industrial policy statute.

IV. Amendments to the Section 301 Authority of the Trade Act of 1974.

Title IV of H.R. 1950 and title III of H.R. 2809 provide for a number of changes in section 301 and following sections of the 1974 Trade Act. These provisions transfer much of the President's present authority under section 301 to the USTR. They provide for certain additional specific steps (such as the negotiation of orderly marketing agreements) that may be taken pursuant to section 301 to authorize the restriction or denial of service sector authorizations, provide for consultation with industry during section 301 investigations, and significantly alter current section 304 of the 1974 Trade Act providing for section 301 investigations. In addition, they contain significant new provisions regarding industrial targeting practices.

1. Purpose of Section 301. Section 401 of H.R. 1950 (section 301 of H.R. 2809) amends the basic 301 authority to authorize the Administering Authority to "offset or otherwise respond" to unfair trade practices.

- We oppose this change. Section 401 would shift the emphasis of section 301 investigations from the elimination of restrictions on trade and investment towards the provision of import relief. Section 301 should not become an alternative route to obtain import relief currently available under section 201. Moreover, section 301 in its present form provides ample and flexible authority to obtain the elimination of unfair trade practices.

- Section 401 would significantly narrow the options presently available to the President under section 301. It would limit the President and the USTR to actions specifically enumerated in section 401(b). These actions tend to emphasize protectionist steps at the expense of actions calculated to remove unfair trading practices and open foreign markets. The result is diminished Presidential discretion and flexibility.

2. Investigations Under Section 301. Section 402 of H.R. 1950 (section 302 of the H.R. 2809) provides for a number of changes in the ways section 301 investigations would be carried out. They provide for the filing of detailed questionnaires with foreign governments and enterprises, the certification of information provided, and use of the best information available. In addition, these provisions provide for preliminary determinations and final determinations, as well as immediate action following provisional determinations.

- In our view, these provisions would substantially hamper the USTR's ability fairly and expeditiously to investigate alleged unfair trading practices, and would therefore be counterproductive. We believe that section 301 presently provides the President with the necessary flexibility and authority to conduct thorough and expeditious investigations under section 301.

3. Industrial Targeting. Section 403 of H.R. 1950 (section 303 of H.R. 2809) significantly alters current law regarding industrial targeting. Section 403 creates, in essence, a new section 301 for industrial targeting practices, as defined in section 401(e)(1), by creating a new section 305 providing for an investigation of such practices, and a new section 306 providing for mandatory retaliation where such practices are determined to exist.

The principal grounds on which we must oppose these provisions are as follows:

- First, under this section, if both the USTR and the Commission make affirmative preliminary or final determinations with respect to industrial targeting, the USTR is required to take certain retaliatory actions under section 301 (while it is true that this requirement can be avoided if agreements are entered into with the offending countries, as a practical matter this alternative may not always be available). Mandatory provisions of this nature cannot be supported by the Administration. They limit the President's flexibility in managing international affairs, and may be counterproductive by impinging upon negotiating strategy.

- Second, these provisions are not necessary. The President already has the authority to act to discourage or eliminate unfair targeting practices.

- Third, insofar as they provide for additional advisory structures of a tripartite nature, these provisions sound of "industrial policy" and are therefore contrary to the Administration's policy of permitting free market forces to pick "winners" and "losers". The ISAC structure presently provided for by section 135 of the 1974 Trade Act, together with the President's Export Council, provide the President with valuable advice from the private sector. Additional advisory bodies for this purpose are neither necessary nor advisable.

- Fourth, there is no international consensus on what constitutes targeting or on the extent to which it is prohibited by existing international agreements.

- Fifth, insofar as they require the ITC to determine whether the domestic industry is injured by the targeting practices, these provisions impose an additional obstacle to relief for domestic industry. In light of the likely difficulty of establishing a causal link between the targeting and the injury, adding an "injury" requirement will almost certainly prove counterproductive.

Mr. Florio. Thank you very much. I am pleased to call our first panel of witnesses which is comprised of Mr. John Ong, chairman of the board and chief executive officer, B.F. Goodrich Co.; Mr. Howard Samuel, president, Industrial Union Department, AFL-CIO and the co-chairman of the Labor-Industry Coalition for International Trade; and Mr. Alan Wolff of Dewey, Ballantine, Bushby, Palmer and Wood of Washington, DC.

Gentlemen, we would ask you to come forward, take your place at the witness table. As with all of our witnesses, any formal statements they may have will be put into the record and they may proceed as they sit fit. We would ask our witnesses to introduce any colleagues that they may have accompanying them for the record.

Before we go forward, we have one of our more interested members of the subcommittee who was unavoidably delayed, and I would ask at the outset if he has any opening comments, Mr. Sharp from Indiana, before we go forward with our panel.

Mr. Sharp. Thank you very much, Mr. Chairman. I compliment you on having this hearing because I think we're dealing with the most critical economic issue of our time and will be in this country for the next decade or two, about how we grapple with the international economy.

It strikes me that it's very clear, and I hope to everybody, that no longer do simple phrases like "free trade" or "Buy American" provide an adequate policy, although they seem to be heavy in everybody's speeches. I think the fact is that we have terribly missed the boat in the last couple of years, in coming to grips with this problem on two accounts, and particularly with respect to the international value of the dollar.

And yesterday's events where the House and Senate budget committees were posturing about the deficit and quibbling over about $16 billion worth of differences is just absolutely childish. The fact is if we don't come to grips with that deficit we are going to pay a deep and heavy price, which is being paid in my district and around this country.

Just last week a major very successful international corporation in my district announced a 2,200 person layoff as a result of intensifying competition on the international scene. And that industry and industry after industry are making fundamental investment decisions this year to move abroad because they cannot compete in the marketplace if they don't do something that dramatically reduces their costs or compensates for the advantages that other governments give their industrial base.

And so it is absolutely imperative that we move forward first on the deficit and then, with some kind of governmental intervention which supports what you're doing on the deficit in terms of the value of the dollar.

That's not the only problem here, obviously, but we have just, in this Congress and this administration, still just danced around as if this deficit is irrelevant, as if we can just wait our way through the international situation, and yet the investment decisions are being made right now, this day and tomorrow that are going to change the landscape of this economy, and I think it's high time all of us took it dramatically more seriously. And I appreciate the fact that you are, Mr. Chairman.

Mr. Florio. Thank you very much. Mr. Ong.

STATEMENTS OF JOHN D. ONG, ON BEHALF OF LABOR-INDUSTRY COALITION FOR INTERNATIONAL TRADE, ACCOMPANIED BY BRIAN TURNER, DIRECTOR, LEGISLATION AND ECONOMIC POLICY, INDUSTRIAL UNION DEPARTMENT, AFL-CIO; HOWARD D. SAMUEL, PRESIDENT, INDUSTRIAL UNION DEPARTMENT, AFL-CIO; AND ALAN Wm. WOLFF, COUNSEL, LABOR-INDUSTRY COALITION FOR INTERNATIONAL TRADE

Mr. Ong. Thank you, Mr. Chairman. Before I begin I would like, as you had requested, to introduce two of our LICIT colleagues who are at the table with us this morning. To my extreme left is Brian Turner, legislative director of the Industrial Union Department of the AFL-CIO, who is the labor coordinator for LICIT, and to my immediate right, Alan Cors, vice president, government relations of Corning Glassworks who is the industry coordinator for LICIT.

Mr. Florio. Gentlemen, welcome to the committee.

Mr. Ong. My name is John Ong, and as you have said, I am chairman and chief executive officer of the B.F. Goodrich Co., and I'm here this morning representing my company as a member of the Labor Industry Coalition for International Trade, or LICIT, as it is usually known.

LICIT, as you are aware, is an organization made up of a number of large industrial labor unions and a number of large industrial companies. Our purpose in banding together is to attempt to take initiatives and press for the creation of a meaningful trade policy and meaningful modernization of trade legislation in this country.

We are very encouraged by the legislation which is now in the House, and it is our purpose today to further the interest of this subcommittee in the passage of this legislation.

I would, in summarizing the formal statement which has been filed for the record, simply point out, as is I believe widely known and well appreciated by the members present here this morning, that there is a crisis in the tradeable goods sector in this country, both in manufacturing and in agriculture. This is no longer exclusively a manufacturing or industrial sector problem; it has become an agricultural problem, too, and we think that speaks to the breadth of the problem and the need for broad support within the Congress for legislation of the type which you are considering today.

The trade deficit has been spiraling upward. One has to wait each day for new estimates. The most recent one I have seen is $140 billion; a figure unimaginable only a few years ago. Reference has been made to the reduction of deficits, and certainly all of us in LICIT would very much support all moves in the public sector, moves currently afoot in the Congress, to deal with the deficit question, and to help with the problem of major dollar inflows which are resulting in a heavily over-valued dollar.

I would emphasize, however, that contrary to some opinion that has been expressed, it is our very strong conviction that the trade difficulties we face, the trade deficit situation that we are wrestling with, will not be eliminated even if the dollar exchange rate imbalance were to be somehow magically eliminated overnight. We would still have the larger part of our total trade difficulty to be solved. There are structural problems in the world trading system that need to be dealt with in addition to the dollar problem.

Last year, I was privileged, along with Mr. Samuel, to be a member of the President's Commission on Industrial Competitiveness, which went about its work from late 1983 through the end of 1984. And I was cochairman of the Committee on International Trade of that Commission.

A number of recommendations that were made by the Commission to the President are very much like the LICIT proposals which are incorporated in parts of the legislation under review.

As the President's Commission looked at the trade problem, we came up with two broad observations which I think are important in setting the stage for your discussion of this legislation. First of all, we need to have national priority placed on the creation of trade policy. It was the perception of our Commission that there is no trade policy. It's not that we have a poor trade policy or an ineffective trade policy; we don't have any trade policy at all in any meaningful sense. And trade now needs to be a national policy priority.

Second, we made the broad observation that there is a major problem within the world trading system relating to fairness, and that fairness in world trade is something that needs to be addressed by the Congress and by the administration in this country.

Let me just briefly underscore those two points. First, as to the need for priority in setting meaningful trade policy. I think it's very simple. The reason we have not had a national trade policy, is that at one point in the not too distant past, we didn't really need it. If you go back to the 1950's and 1960's, our gross national product represented something like three-quarters of the gross national product of the world. As recently as 1960, a mere 25 years ago, imports represented only about 5 percent of industrial and agricultural activity in this country, and exports were only about 8 percent of our GNP.

In the last 5 years on average, by way of contrast, imports have represented 32 percent of value of goods consumed in this country, and exports now represent about 26 percent of our manufactured production. So our participation in the world trading system is now a vital, critical, major element in every industry and in every region of the country.

As to fairness, there has been a great deal of attention paid just in the last 2 years to public perception of fairness in world trade. A number of interesting public opinion surveys have been made. I'm sure you're familiar with many of them. And I would cite them broadly only to say that there is a strong and noticeably growing feeling among the public as a whole that the United States is somehow or other being treated unfairly in the world trading system, and that the public sector needs to take action in order to redress the balance.

Referring once again to the Presidential Commission on Industrial Competitiveness, the PCIC made a couple of very specific recommendations with regard to this fairness issue, and I'd like to mention them because they are reflected in the legislation which you're considering.

First of all, the Commission recommended to the President that there needed to be a task force which would include representatives of the relevant parts of the executive branch as well as representatives from agriculture, industry, and labor, to look at and study carefully our trade laws and recommend improvements which could be legislated; improvements specifically in the industry adjustment laws, in our ability to respond to the so-called targeting practices which are current as part of the national policy of a number of our major trading partners, and also, to strengthen the existing U.S. trade laws that provide protection for American firms and American workers against unfair trade practices of other countries or citizens of other countries.

Second, the Commission recommended to the President that we needed to take the preliminary steps necessary to undertake a new series of GATT negotiations sometime in the near future for the purpose of making GATT, if possible, once again a relevant, meaningful document and instrument in governing world trade.

As you're well aware, in recent years, the developments in the world market have made GATT increasingly less relevant, have caused its coverage to represent now a rather small proportion of all trade activity around the world. There are many areas, agriculture, services, that need to be covered, many kinds of practices generally described as nontariff barriers, which need to be covered by the agreement. And coverage needs to be extended to many countries which are now not covered at all or not covered in any effective way.

We are very encouraged as a coalition of interested, vitally interested, companies and unions in the introduction of House bill 1950.

We are delighted that this subcommittee and your committee, in turn, are holding these hearings. We were encouraged at the introduction of counterpart legislation in the Senate just yesterday. Many of the provisions of the legislation at hand reflect some of the recommendations of the President's Commission on Industrial Competitiveness. They certainly reflect some of the ideas which we at LICIT have been discussing with opinion leaders in the Congress over the last several years, and we are encouraged that this is at long last the beginning of the road toward a meaningful congressional action in this area.

Thank you.

[The prepared statement of Mr. Ong follows:]

Statement of

John D. Ong
Chairman and Chief Executive Officer
The BF Goodrich Company

On Behalf of

The Labor-Industry Coalition for International Trade

Mr. Chairman:

My name is John Ong. I am Chairman and Chief Executive Officer of the B.F. Goodrich Company. I am here along with other member organizations of the Labor-Industry Coalition for International Trade (LICIT) to discuss with you the need to make trade a national priority for our country.

The crisis in our tradable goods sector -- primarily manufacturing and agricultural activities -- has been continuing for so long that it threatens to change from being a crisis to becoming an accepted part of our economic life. The historically unprecedented trade and current account deficits are losing their shock value as the red ink in our trade account continues. The Commerce Department is projecting a new record trade deficit this year, perhaps exceeding $140 billion. No one can really say when it all will end.

There is no easy or quick or painless way to reverse the growing trade deficits. Significant progress toward reducing the historically large U.S. budget deficits, relative to our supply of savings in the economy, would help by reducing the need for net capital inflows that keep the dollar at very high levels. I think there exists substantial consensus in the country about the need to achieve this objective. However, it is not at all clear that, politically, it will soon be accomplished.

Yet, despite any progress that may be achieved concerning our fiscal policy, this country will still need to address many significant trade problems.

This was one of the major conclusions of the recently concluded report by the President's Commission on Industrial Competitiveness (PCIC). I had the privilege of serving on that Commission. I also was the chairperson of the Committee on International Trade for the PCIC. I would like to briefly summarize the major recommendations of the Commission because they are quite similar to many of the proposals on modernizing our trade policy apparatus that LICIT has independently put forward. The significance of the existence of these two sets of similar proposals is that it indicates an important start toward a general consensus on what the United States should do to modernize its trade laws and policies.

The members of the President's Commission came to two general conclusions about what should be done with respect to America's approach to international trade:

(1) trade should be a permanent national priority; and

(2) fairness in the world trade system must be maintained.

These two general conclusions may seem mundane and obvious. But the facts are that trade is not a national priority and world trade is often not conducted on a fair basis.

Historically, it is easy to understand why trade has generally been a secondary concern of U.S. policy makers. As recently as 1960, U.S. imports of manufactured products represented only 5 percent of manufacturing output while American industry exported about 8 percent of its manufacturing production. This situation has change dramatically. Over the last 5 years the comparable figures averaged 32 percent for imports and 26 percent for exports. Trade has become a necessary priority for American manufacturing companies and industrial workers. This economic situation must be reflected in the formulation and implementation of government economic policy.

The issue of fairness in world trade is extremely important. Because international trade not only provides opportunities for increased economic growth and efficiency, but also results in economic dislocation and job loss, it is essential to maintain fair rules of the game to ensure political acceptance for an open trading system.

Public opinion polls indicate that many Americans believe that the United States does not receive a fair deal in world trade; that other countries often profit at our expense.

The PCIC recommended two actions to address the issue of fairness in the international trading system.

(1) The first recommendation was the formation of a task force on U.S. trade laws comprised of government, business, labor and agriculture

representatives, to examine current trade laws and propose improvements in them. Specifically, the PCIC recommended that the objective for reform in the trade laws should be:

- -- to improve industry's ability to adjust to increased competition;
- -- to respond to the trade effects of foreign industrial targeting; and
- -- to strengthen U.S. laws governing unfair trade practices.

(2) The second recommendation, dependent upon and related to the first, was the initiation of preparations for a new round of GATT talks to deal with key trade issues of the coming decade and to bring the developing countries more within the orbit of the multilateral trading system.

The PCIC recommendations are very similar to provisions in the Trade Law Modernization Act (H.R. 1950) that has been referred to both the Energy and Commerce Committee and the Ways and Means Committee. A similar bill was introduced in the Senate yesterday. LICIT strongly supports the trade law provisions presented in these bills as a key element of the economic policy changes required in our country. The hope is that these recommendations, like those of the PCIC, achieve two results: (i) initiate a debate about the adequacy of current U.S. trade laws, and (ii) provide the basis for a well-reasoned modernization of those laws around which broad public support can develop.

Thank you Mr. Chairman. I will be happy to answer any questions you or other members of the subcommittee may have.

Mr. Florio. Thank you very much.
Mr. Samuel.

STATEMENT OF HOWARD D. SAMUEL

Mr. Samuel. My name is Howard Samuel, president of the Industrial Union Department of the AFL-CIO. We are a semiautonomous division of the AFL-CIO representing 55 international unions, most of them in the industrial sector.

Let me first confirm that Mr. Ong's testimony in regard to the President's Commission is indeed accurate, and I think adds extra evidence to the fact that the bill that we are discussing today, H.R. 1950, does represent a remarkable consensus I'm not sure too often seen before among labor, among agriculture and business. When I talk about business, I'm talking both about the traditional businesses, so-called smokestack industries, as well as high technology.

Based on the names of those who have already sponsored the bill both in the House and the Senate, it also represents a consensus of both parties.

One of the major factors in achieving this consensus, I believe, is the growing recognition among all of us involved with international trade and in the Congress that the crisis we are facing now is neither temporary nor sectoral and that it is, indeed, a crisis. We are well aware that the high-technology industries have been just as badly affected as the smokestack industries in recent years and months. Industries such as computer-controlled machine tools and semiconductors are just the most recent victims, but the fact is that a majority of our high-technology industries have been losing market share for almost 20 years.

We are also aware that our trade problems in a number of industries began long before some of the issues regarding the dollar, the overvalued dollar, and that those problems will not disappear if the dollar achieves parity, as John Ong indicated.

This bill seeks to address those nonsectoral, long-standing issues affecting our trade relations. It would strengthen the conduct of our trade policy by placing responsibility in one center of responsibility, reporting directly to the President; by providing more resources for research and analysis; and by strengthening the links between government and the private sector.

The bill also modernizes elements of U.S. trade law which have been made obsolete by the recent practices of our major competitors. Much of our trade law, Mr. Chairman, was designed at a time when the underlying foundation of international trade was comparative advantage, based on what economists call factor endowments.

Today trading supremacy depends only in part on such elements as skilled labor, natural resources, the availability of capital for investment, and manufacturing and merchandising know-how. To an even greater extent, we have seen that supremacy in the international trading arena now depends more on how governments manipulate all these factors to support key industrial objectives.

The most important factor endowment today may be government agencies such as Japan's Ministry of International Trade and Industry, MITI, which I don't think is what Adam Smith had in mind. We are still guarding ourselves against late 19th century practices in our trade laws, and as a result, we have left ourselves relatively helpless in the face of the industrial targeting, subsidy, market access restriction, and other late 20th century practices of most of our trading partners.

Our bill is designed to correct this failure, to bring our trade law into the 1980's and 1990's. If we fail and continue to fall behind, the result could be continually growing trade deficits, with a disastrous effect on our economic stability and employment.

Were this to continue, Mr. Chairman, H.R. 1950 in some future year will be perceived as being quite inadequate, and we could well return to an earlier period characterized by the Smoot-Hawley Trade Act of 1930. For those who fear protectionism, this bill may be our best defense.

Thank you.

[The prepared statement of Mr. Samuel follows:]

Testimony of
Howard D. Samuel, President
Industrial Union Department (AFL-CIO)

before the

House Energy and Commerce Committee
Subcommittee on Commerce, Transportation
and Tourism

June 26, 1985

Mr. Chairman, members of the Committee, my name is Howard D. Samuel and I am president of the Industrial Union Department (AFL-CIO). The IUD represents 55 national and international unions with some 5 million industrial members in the United States.

The occasion for these hearings could not be more serious. The country is enduring the greatest trade deficit not only in this nation's history but in the history of human society -- and this in a country that never had a trade deficit in this century prior to 1971. The record trade deficit last year of $123 billion represents a loss of three million jobs, using government estimates of 25 thousand jobs for every billion dollars of trade.

Many in America have been disturbed by the apparent lack of policy direction in what are certainly changed and, for the United States, detrimental circumstances in international trade. That group of concerned Americans includes all of the members of the labor-industry coalition for international trade, LICIT.

It is evident that there is a need for national leadership on international trade questions. Such leadership can arise from a Congressional initiative in the first instance, but ultimately it will need joint support from Congress and the Executive Branch.

We believe that America's trade problems require a broad based, comprehensive and well thought-out response at this time.

LICIT has helped develop and strongly supports the Trade Law Modernization Act, H.R.1950, which we recommend to your consideration as such a comprehensive and well focused initiative. It addresses three areas of concern, which correspond to three areas of pressing need in the conduct of U.S. international trade policy:

- The administration of U.S. trade law, including executive branch consultation with Congress and the private sector;
- Defining U.S. objectives for multilateral negotiations where new international trade rules are required;

- Substantive reform of U.S. trade law, particularly where U.S. law and policy have been overtaken by rapid changes in today's realities of international competition.

The conduct of U.S. trade policy within the executive branch needs to be strengthened in terms of resources and functions; and the administration's ongoing communication with Congress and the private sector -- industry, labor and agriculture -- needs to be enhanced. The reconnaissance and analytical capability of the executive branch on matters affecting international competition and international economic developments in various economic sectors and countries should be substantially enhanced: we cannot successfully operate a trade policy without first rate and timely analysis of economic and policy developments around the world that will affect U.S. export and import-competing industries. Likewise, the often dispersed authority for making trade policy decisions needs to be better concentrated in a single location, at the cabinet level, so that trade concerns can be coherently negotiated with other countries and so that trade policy decisions affecting our economy can be made -- as in other countries -- primarily on the basis of trade considerations rather than primarily on diplomatic or other grounds.

The prospect of a new round of multilateral trade negotiations has been much discussed domestically and internationally in recent months, but U.S. objectives for such negotiations need to be clearly examined and spelled out by the Congress. If this is to be a new round of negotiations, America's objectives for them must include greater discipline in the actions by governments which can have the effect of completely transforming or distorting "comparative advantage" to the point that other nation's producers, otherwise competitive, have no chance in the marketplace. This includes export performance requirements, government support for export industries, and other innovative subsidy-like practices. International negotiations on trade should as a matter of priority include or be linked to negotiations on the exchange rate system, as part of an effort to redress the harm stemming from a massively overvalued dollar which is contributing as much as anything to the gutting of America's industrial sector.

Finally the bill modernizes parts of U.S. trade law which have been overtaken by the rapid growth in the scale of America's international trade and by the rapid development of innovative trade practices by other countries -- practices to which current U.S. trade law has proven inadequate. It provides offsetting action when foreign industrial targeting practices or provision of subsidized raw materials by foreign governments injures opportunities for U.S. producers denied market access by foreign countries, especially when the U.S. unilaterally opens our own market. The bill eases the more stringent U.S. standard for determining trade injury to conform with the international GATT standard, and provides a procedure whereby government, labor and industry can voluntarily seek industrial modernization, combining trade relief with other measures. And it updatesg the authority of the president and Congress to respond to record trade deficits and the overvalued dollar.

These three main thrusts of reform of U.S. trade law and policy fit together as part of an effective, comprehensive package to deal with America's trade crisis. The linkage between reform of U.S. trade law and objectives for a new round of multilateral trade negotiations is critical: both the U.S. public and our foreign competitors and trading partners need to realize that the U.S. government is and will be serious about upgrading the adequacy of U.S. trade law in dealing with the scope and nature of today's international competition.

The linkage between the exchange rate issues and substantive trade law reform and upgrading the capabilities of those who administer our trade laws is critical. There are some macro-economists who like to say that all of our trade problems are a direct result of the overvalued dollar, and that all of our trade problems, therefore, would resolve themselves if we could bring exchange rates back to their past levels. While we agree on the importance of an overvalued dollar that acts as a tax on all U.S. exports and a subsidy on all U.S. imports, there are many fundamental trade problems that will not be resolved by exchange rate adjustment. The machine tool industry, for instance, was victimized by Japanese targeting starting in the mid and late 1970s -- a period when the dollar was undervalued; the increase of the Japanese share of the U.S. domestic market for numerically controlled machine tools went from 3.6 percent to 60 percent without the benefit of an overvalued dollar. Likewise the provision of two-tier pricing for raw materials and the discrimination against U.S. production in processing raw materials will not be resolved by exchange rate adjustment; the logic of two-tier pricing on natural resource input is to shift higher value-added production to the exporting country at whatever price is needed to get the sales, production, and jobs regardless of exchange rates.

These properly trade policy problems pre-dated the overvalued dollar and will remain when and if the exchange rate is properly realigned.

Finally, Mr. Chairman, let me say a few words about how the questions you are addressing in these hearings are related to issues affecting U.S. competitiveness. Issues involving technology, education and training, taxes, and labor-management relations are all part of this broader effort which our country needs to address in upgrading what has been slagging U.S. competitiveness. John Ong, the chairman of B.F. Goodrich, with whom I am appearing today, was a member of the President's Commission on Industrial Competitiveness, on which I served as one of a small group of labor representatives. John Ong was co-chairman of the international trade committee of the President's commission, and I co-chaired its committee on labor and human resources issues.

We feel that the trade law modernization included in H.R. 1950 is fully consistent with the conclusions and recommendations of the President's Commission. The Commission called for a representative group of industry and labor to examine the needs for improvements in U.S. trade law. It's not quite a coincidence that the proposals in the Trade Law Modernization Act are the result of just such a process among the twenty major companies and industrial unions in the Labor-Industry Coalition for International Trade. I'm not sure if there will be any comparable effort undertaken by another representative group of industry and labor in the near future, so at least for the time being, I'm happy to recommend these proposals to you.

Likewise the President's Commission emphasized the need for labor, industry and government to work together in addressing how we can best address the challenge of international competitiveness facing our country and our individual industries. The channels of increased dialogue between the administration and Congress and the private sector proposed in the bill are one expression of that same intent, as is the option under the "escape clause," section 201, for industry, labor and government to sit down together when an industry is injured by imports and develop a strategy for enhancing the competitiveness of the injured industry. This means a greater likelihood for success in strengthening an industry impacted by trade compared to the option available under current law: restraining imports for a limited period of time and then hoping that the industry can adequately strengthen itself in the interim.

In short, we applaud your initiative in taking up these important subjects and look forward to working with you to help bring some much needed direction to U.S. trade law and policy.

Mr. **Florio**. Thank you very much.

Mr. Wolff.

STATEMENT OF ALAN Wm. WOLFF

Mr **Wolff**. Thank you, Mr. Chairman.

I am Alan Wolff, partner in the Washington office of the law firm of Dewey, Ballantine, Bushby, Palmer & Wood, and counsel to the Labor-Industry Coalition for International Trade.

I would like to summarize my remarks, if I might, and have the entire text reflected in the record.

America is faced with an unprecedented international competitive crisis. Today we are seeing our market rapidly penetrated by foreign imports while U.S. exports are rapidly losing ground in foreign markets. This problem poses a major dilemma for U.S. policymakers.

It is the belief of LICIT that it is essential that the U.S. Government formulate a coherent policy to address the massive and complex problems facing this country, and we feel that LICIT's Trade Law Modernization bill, H.R. 1950, is an essential part of the right response.

The legislation would establish a national trade policy for the United States and a comprehensive package of improvements to modernize the U.S. trade policymaking apparatus.

The Commerce Subcommittee has evidenced in Chairman Florio's recommendations for improvements in section 301 in services in the last Congress the right direction that ought to be taken with respect to the reform of the U.S. trade laws, and it is our hope that that initiative will be built upon in this Congress by this committee and others.

We look forward to looking with you and other members of the Congress in developing sound solutions.

The outlook for change is one that has some degree of hope. Barbara Tuchman, in her book "The March of Folly," talks about wooden-headedness in government, which she says plays a remarkably large role in government. "It consists of assessing a situation in terms of pre-conceived, fixed notions while ignoring or rejecting any contrary signs. It is acting according to wish while not allowing oneself to be deflected by the facts."

She talks about Phillip II of Spain, "the surpassing wooden-head of all sovereigns," saying, "No experience of the failure of his policy would shake his belief in its essential excellence." That is about the position the United States has been in with respect to trade now for several decades.

We have had a marked failure in this government to deal with the Federal budget deficit, the severe over valuation of the dollar, the U.S. trade and current account deficits, the current conflict between the United States and Japan, and the inadequate financing of Third World development.

There have been some encouraging signs, however, in recent months. Seven former chairmen of the Council of Economic Advisers declared that our most fundamental problem was the existence of the Federal budget deficits which are eroding our long-term vitality and stability of the Nation's economy.

Secretary Baker agreed to host a high-level meeting of major industrial countries to take appropriate action on international monetary reform. Secretary of State Shultz in his speech at Princeton talked about the need for budget reform, the problems of the high value of the dollar and the large in flow of foreign capital.

Prime Minister Nakasone has pointed to the need to increase imports into Japan, and at the Paris OECD Ministerial Meeting, European countries agreed that trade negotiations should begin as soon as possible. And now Congress is actively considering budget reductions and tax reform seriously.

However, now that spring has turned into summer, no new proposals have been adopted and no effective measures have yet been taken.

Today's hearing is a welcome and responsible step. It is just possible that some of the wooden-headedness afflicting the Western industrial nations in recent years can be overcome.

Let me just turn for a few moments to the nature of the problems faced and LICIT's notions on some solutions that might be formulated.

Clearly, the trade deficit is an extraordinary challenge for the United States. Decisions on locations of plants are being made daily by American businessmen who are having to rethink their former investment plans and think of placing plants abroad. In addition, American management and labor have been dismayed by the inability of the U.S. Government over the last few decades to take action against unfair foreign practices which have been agreed to be proscribed under international trading rules and still yet persist, and there seems to be an unwillingness in some quarters and an inability generally to evaluate and counteract the detrimental effects of these policies on the U.S. economy.

There is literally a hemorrhage of U.S. manufacturing jobs, and the pressure is being felt for restrictive trade measures, particularly directed against Japan, which accounts for the single largest portion of the U.S. trade deficit.

In my prepared testimony there are statistics which are very familiar to you on the U.S. trade performance, and I will not repeat them orally this morning.

The overvalued dollar may be responsible for some 60 percent of the U.S. trade problem, but it is not responsible for all of our problems. There are external barriers and market distortions that you will hear about this morning from those representing highly competitive companies, including manufacturers of fiber optics and semiconductors, that have had trouble selling in foreign markets and in competition in this market with foreign goods.

The U.S. and Japan are on a collision course. The reason for that is an inability of the Japanese economy to absorb imports, a feeling on the part of many in Japanese business to buy domestic rather than buying on a basis of competitiveness. Those differences are often explained as being cultural. That is not an acceptable answer with a possible $50 billion trade surplus that Japan may have with the United States this year.

It is not a U.S.-Japanese bilateral problem. If Korea and Taiwan and the nations of Southeast Asia could sell their goods freely in

Japan, we would have far less complaint about Japan's trade policies.

LICIT has called upon the Congress and the Executive to reformulate trade legislation because it is Congress that has the commerce powers under the Constitution and it is only the President who is authorized to negotiate with foreign governments.

We have not had new trade laws of any basic sort since 1974. We don't have a means for dealing with orderly adjustment for industries that are having serious difficulties in international trade. We don't have laws that are responsive to foreign industrial targeting that Howard Samuel just described.

We don't have a sole spokesman for trade. The U.S. Trade Representative has zero authority to deal with trade problems. He is the chief spokesman for the United States in trade under law and has no trade authorities whatsoever. That is no way to run a government when we are faced with a trade deficit of something on the order of $150 billion this year.

What is needed is an affirmative national trade strategy. Foreign markets are closed with respect to government procurement. Telecommunications has occupied a lot of the attention of this committee and of the two Senate committees having jurisdiction over this area. The United States is the only fully-open market of telecommunications in the world of any size. Perhaps the United Kingdom and perhaps Sweden are open, but other than that, the entire world is closed to telecommunications and our trade balance shows it.

We do not have in government the analytical capability to even understand what is taking place in our economy or abroad. There is an adversarial posture—I know the subcommittee has felt very strongly about this subject—among labor, government, and business, that prevents us from coming together and discussing policy, discussing problems, and sharing in trade remedy deliberations and evaluating the problems facing the United States.

There is an inability somehow in recent years for the Congress and the executive to come together and craft trade policy solutions together.

We have suggested in the LICIT bill a requirement for an annual approval of a general trade policy plan by the committees having jurisdiction in the Congress over trade and investment. This would force closer coordination of Congress and the executive branch in trade formulation and also give the private sector, both labor and management, an opportunity to be heard as well.

If there were a politically more responsive system of trade policy formulation in place, it would be possible to undertake a basic overhaul of U.S. trade laws to make them more effective and responsive to international competitive realities.

The reforms we have listed are not exhaustive. They are illustrative, rather than comprehensive. Other measures will suggest themselves to members of this committee, if and when U.S. trade policymakers are able to make underlying philosophical changes of attitude—namely—and this was something that the Commission on which both Howard Samuel and John Ong serve, the President's Commission on Competitiveness—there must be a change of attitude on the part of the American Government.

International competitiveness of American industry is vital to the well-being of this country and to its national security and to its foreign policy interests.

Paradoxically, only the successful pursuit of national economic self-interest will give the United States the means to keep its own markets open, enable it to provide the necessary leadership to maintain a relatively open international trading system. There will be little willingness by other nations to follow the lead of a country that is not a strong competitor in its own right.

Mr. Chairman, we feel that the LICIT Trade Law Modernization Bill, H.R. 1950, would contribute significantly toward progress in that direction.

Thank you, sir.

Mr. Florio. Thank you very much. I appreciate the very succinct and the very clear statements of the three witnesses.

[Testimony resumes on p. 130.]

[The prepared statement of Mr. Wolff follows:]

STATEMENT OF

ALAN WM. WOLFF, Partner,

DEWEY, BALLANTINE, BUSHBY, PALMER & WOOD

COUNSEL TO THE

LABOR-INDUSTRY COALITION FOR INTERNATIONAL TRADE

TRADE LAW MODERNIZATION: THE NEED FOR A NEW INTERNATIONAL ECONOMIC CONSENSUS

Mr. Chairman, I am Alan Wm. Wolff, Partner, Dewey, Ballantine, Bushby, Palmer & Wood, and counsel to the Labor-Industry Coalition for International Trade (LICIT). LICIT counts among its members labor unions and industry corporations that represent over 5 million American workers and account for $90 billion in sales with operations in every state of the Union. I am pleased to have the opportunity to appear before your Subcommittee today.

America is faced with an unprecedented international competitive crisis. Today we are seeing our market rapidly penetrated by foreign imports while U.S. exports are rapidly losing ground in foreign markets. This problem poses a major dilemma for U.S. policymakers.

LICIT believes it is essential that the U.S. government formulate a coherent policy to address the massive and complex problems facing this country. We are convinced that the LICIT Trade Law Modernization bill (H.R. 1950) provides an essential part of the right response -- the legislation would establish a national trade policy for the United States and a comprehensive package of improvements to modernize the U.S. trade policy making apparatus.

On behalf of LICIT, I wish to ccommend the Commerce Subcommittee for its responsible and concerned leadership over trade law reform as evidenced in Chairman Florio's recommendations for improving Section 301 to address trade in services enacted in the last Congress. We look forward to working with you and others in the Congress in developing sound solutions.

OUTLOOK FOR CHANGE

Barbara Tuchman commented in her recent book, The March of Folly,

> "Wooden-headedness, the source of self-deception, is a factor that plays a remarkably large role in government. It consists in assessing a situation in terms of pre-conceived fixed notions while ignoring or rejecting any contrary signs. It is acting according to wish while not allowing oneself to be deflected by the facts. It is epitomized in a historian's statement about Philip II of Spain, the surpassing wooden-head of all sovereigns: 'No experience of the failure of his policy would shake his belief in its essential excellence.'"

This quotation could no doubt be applied with equal force to any number of government policies in recent history. Until just a few months ago, when signs of a beginning of a possible re-direction of U.S. policy became evident, it would certainly have been applicable to U.S. economic policy affecting international trade.

Until then, there had been a marked failure of the U.S. government and the academic community to appreciate and seek remedies to the obvious adverse consequences for the U.S. and world economy of

- the Federal budget deficit,
- the severe overvaluation of the U.S. dollar,
- the U.S. trade and current account deficits,

- the inadequacies of the international trading, financial and monetary systems,
- the current conflict between the United States and Japan, and
- the inadequate financing of Third World development.

There are now some encouraging signs:

-- In March, seven former chairmen of the Council of Economic Advisers -- Walter Heller, Gardner Ackley, Paul McCracken, Alan Greenspan, Charles Schultze, Murray Weidenbaum, and Martin Feldstein -- declared

> "Despite our different views on some matters, as professional economists we are of one mind about the fundamental dangers which the continued existence of such [budget] deficits poses for the nation. Most seriously, continued federal deficits of the amounts now projected would erode the long-term vitality and stability of the nation's economy. Even in the nearer term, however, the persistence of massive federal borrowing during a period of economic expansion can bring in its train mounting risks to the maintenance of economic stability at home and in the world economy."

-- In April, the United States Treasury Secretary agreed to host a high-level meeting of the major industrial countries to take appropriate action on international monetary reform.

-- The Secretary of State, speaking at Princeton, proposed "a program of international action" to protect world economic recovery, with the major U.S. contribution to be a reduction in its budget deficit -- recognizing that the federal budget deficit is a reason for the nation's record trade deficit, the high value of the dollar, and the large inflow of foreign capital.

-- Japanese Prime Minister Nakasone went on television to talk to the Japanese people about being more receptive to buying more foreign-made goods.

-- In Paris, at the OECD Ministerial Meeting, European countries, reacting to new American flexibility with respect to a discussion of international monetary reform, agreed that multilateral trade liberalization negotiations should begin as soon as possible.

-- Finally, in recent months, both Houses of Congress have begun to consider budget reductions and tax reform seriously, and have increasingly evidenced signs of concern over the country's trade posture.

Unfortunately, now that Spring has turned into Summer, nothing in fact has changed. No new proposals have been adopted. No effective measures have been taken.

-- Yet there is still a distinct possibility that change is possible.

Today's hearing before your subcommittee is a welcome and responsible step forward. It is just possible that some of the "wooden-headedness" afflicting the Western industrial nations in recent years will be overcome. Clearly, a significant change in the policy making apparatus on trade is the role of the Congress. In the last few years, the catalyst for change for improving U.S. trade laws has found its impetus in a Congress that has turned its attention more and more to the massive trade problems plaguing this country.

THE IMPACT OF THE TRADE DEFICIT

The trade deficit is altering the shape of the U.S. economy, seriously, and predominantly negatively. The overvalued American dollar is continuing to affect trade and investment decisions throughout the American economy and abroad.

A major determinant of the location of new plants, or the expansion of existing ones, has become a judgment as to whether the United States is an economically viable place for sourcing products to serve either foreign markets or the domestic market. Starting several years ago, with the rise of the value of the dollar vis-a-vis the currencies of other major trading countries, businessmen began to rethink their investment plans.

In addition, many in American management and labor have been dismayed by the inability of the U.S. Government over the last few decades to take action against unfair foreign practices which are agreed to be proscribed under international trading rules. U.S. business and labor have sought a positive response from the Administration and from the Congress, but have found there an unwillingness in some quarters and inability more generally to evaluate and counteract the detrimental effects on the U.S. economy.

The result is a hemorrhage of manufacturing and of manufacturing jobs from the United States. With this pressure has come calls for restrictive trade measures. The greatest anger has been directed against Japan, which accounts for the largest single portion of the U.S. trade deficit.

SOME BASIC FACTS ABOUT AMERICAN TRADE

From 1970 to 1984, global trade has grown sevenfold, faster than U.S. economic growth. Now almost one-quarter of American industrial production is for export to foreign markets, and one out of every four acres is planted with crops destined for consumption abroad. Seventy percent of U.S. manufactured goods compete with foreign goods either in the U.S. market or in foreign markets.

The direction of trade has been shifting. Now U.S. trade with the Pacific Rim countries is almost double the amount of U.S. trade with Europe.

U.S. trade performance, as measured by the trade balance, has been steadily deteriorating. Until very recently, neither the trade deficit nor the budget deficit has been viewed as a serious problem (nor even admitted to be a problem at all) by senior U.S. Administration economic spokesmen.

Of the $120 billion plus deficit, some $70 billion is with industrialized countries (a deterioration over the last five years of a startling $65 billion in the U.S. trade balance with these countries), and $50 billion with the developing countries (a deterioration of $18 billion over the same period).

American industry was and is in serious trouble. It is no solace for American firms and workers, nor for our trading partners wary about the growth of protectionist sentiment in the United States, to say that American firms which survive this period of severe dollar overvaluation will be highly competitive.

THE CAUSES OF POOR ECONOMIC PERFORMANCE

There are many causes of the declining United States' share of world exports and production. Some of these need be of no particular concern. Other aspects of the disappointing American performance are distinctly troubling, however.

-- The Overvalued dollar. Perhaps some 60% of America's current trade problems may be traced to the value of the dollar. The Administration estimates that the U.S. dollar is now about 68% above its value in 1980 due to net capital inflows. This should not be held to be anything but devastating in its long-term effects on the U.S. economy. It has been the principal cause for the lop-sided nature of the economic recovery which has taken place over the last two years -- for every four jobs created in the services industries, one job has been lost in manufacturing. Thus, despite the strong economic recovery in the United States, manufacturing employment has not fully recovered to the level of prior years.

-- External barriers and market distortions. Not every cause of relatively poor performance of U.S. industries can be blamed on macroeconomic policies. There are also areas in which United States' industries are and have been highly competitive but where foreign market access has been denied. The most highly-publicized of these is currently that of telecommunications. Fiber optics is another case in point. More recently, the story of competition between the United States and Japan in semiconductors has taken the headlines.

-- The Collision between Japan and the United States. The sharp nature of the trade conflict between the United States and Japan deserves a few words of explanation.

At one level, the hostility toward Japan is generated by the experiences of literally thousands of American and other foreign businessmen who have felt that they have not been dealt with fairly by either Japanese Government agencies or by Japanese industry. This has often been attributed to cultural differences between Japan and the rest of the world. The word "cultural" tends to do more to obscure than illuminate the wellsprings of the difficulties in penetrating the Japanese market. There is a tendency on the part of many segments of Japanese business to prefer to deal only with certain domestic companies and individuals with which there are long-standing relationships. This anti-competitive behavior has unfortunately been reinforced by policies of the Japanese government.

But of equal or greater importance, Japanese government policies have made Japan an extraordinarily poor consumer of the world's, not just American, goods. In fact, the current debate is greatly distorted by discussing the competitiveness of American goods in the Japanese market when it is all foreign manufactures that are at issue, not just American. For example, access is also denied to Korean and Taiwan products in the Japanese market; (the converse is true for U.S. goods denied access in Korea and Taiwan).

There is no fundamental solution to U.S.-Japanese relations to be found in any specific list of nontariff trade barriers to be removed by Japan. The problems are too pervasive and deep-seated to be remedied by any limited set of import or export promotion measures on either side of the Pacific Ocean although these might address specific problems. The time has come for frank talk about each other's economies and fundamental reforms rather than finger-pointing and threats.

THE NEED FOR NEW APPROACHES TO TRADE POLICY FORMULATION

Beyond the massive problems outlined above, this country still faces critical problems in the global marketplace which are not adequately addressed by U.S. trade policy or law. For example,

-- We do not have a means of adequately dealing with trade adjustment for industries, workers and communities that suffer from unfair foreign competition.

-- We do not have laws that effectively address foreign industrial targeting.
-- We do not have a sole spokesman on trade who is accountable. The Trade Representative is a cabinet level officer -- the U.S. Government's chief trade official but with no trade authority to administer or enforce, for example, trade remedies laws.

While major trade legislation is enacted only rarely, the proliferation of new and ingenious government practices to direct trade flows for national gain and the complex developments relating to new disciplines such as trade in services, high technology and foreign investment have made it increasingly apparent that new trade legislation is needed.

It has been over a decade since the full scope and structure of the trade remedy statutes have been systematically examined by the Congress. These current trade remedies are no longer adequate to address the problems of international competition currently facing U.S. manufacturing and service industries. Moreover, the objectives of these laws have become increasingly unclear. In addition, relief, in those cases where it is ultimately granted, is often ineffective, there being little attention given to either fundamental causes of an industry's competitive difficulties or to an appropriate combination of remedies.

Implementing an affirmative national trade strategy means, first and foremost, pulling together the disparate strands that constitute current U.S. trade policy into a coherent whole. LICIT strongly believes there is a need to establish a better capability to both understand the changing international competitive situation of American industry and to formulate and implement an effective response.

As important as the foregoing changes would be, of even greater importance is a change in the adversarial posture that exists between industry, labor and government. The time has come to move toward a system in which consensus policies can be formulated. If pro-competitive policies are to be adopted, industry, labor and government (both the Executive Branch and the Congress) must be able to meet together to discuss policy, share in trade remedy deliberations, and evaluate analytical work on U.S. and foreign industrial competitiveness.

No institutional framework currently exists for bring the Executive, Congress and those in industry and labor affected by public policy decisions together to formulate trade policy. This would not be difficult to do. One means to do this would be to require annual approval of the general trade policy plan and priorities for the year by the committees of the Congress with jurisdiction over trade and investment. This would force closer coordination of all the factors involved in trade policy formulation.

With a politically more responsive system of trade policy formulation in place, it would be possible to to undertake a basic overhaul of U.S. trade laws to make them more effective and responsive to international competitive realities.

These reforms are illustrative rather than comprehensive. Other measures will suggest themselves if and when U.S. policymakers are able to make the underlying philosophical change of attitude -- namely, that the international competitiveness of American industry is vital to the well-being of this country and its national security and foreign policy interests. Paradoxically, only the successful pursuit of national economic self-interest will give the United States the means to keep its own market open and enable it to provide the necessary leadership to maintain a relatively open international trading system. There will be little willingness by other nations to follow the lead of a country that is not a strong competitor in its own right.

CONCLUSION

The first and most important cure to the trade problems that the United States and the world trading system currently face is to be found at home. The principal problem is the overvaluation of the dollar and the principal cause of that problem is the immense Federal budget deficit. However, not all trade problems will disappear with a currency realignment or responsible fiscal and monetary policies. Absent specific efforts aimed at improving our responses to trade problems, trade frictions will continue to grow and the percentage of world trade under restriction will continue to grow.

The LICIT proposal contains a balanced set of domestic and international commercial policies which would have the desirable effect of improving the way in which the American government responds to the challenges of international competition. The LICIT bill picks up on a number of the recommendations in the Young Commission report and would be a good starting place for crafting a new set of necessary responses.

The need for cooperative and innovative solutions has not been greater since the establishment of the GATT and Bretton Woods. There is no reason why wooden-headedness need prevail when there is so much at stake. New approaches need to be taken in order to begin to make some progress. The LICIT Trade Law Modernization bill (H.R. 1950) would contribute significantly towards that progress.

Mr. **Florio**. Just commenting on Mr. Wolff's observation about woodenheadedness in terms of governmental policy, I think it almost is deeper than governmental policy. It's the basic ethic of our economy, which has always been couched in terms of free enterprise, couched in terms of marketplace forces operating in the competitive environment. And when you translate that philosophy into the international scene, we see that in some respects that's irrelevant, that we're not talking about marketplace forces operating internationally. We're not talking about a truly competitive environment. We're talking about businesses competing against governments, or in some instances, government consortiums. When you talk about the absence of cooperation between the administration and the Congress, you're correct, but I think it's fair to say that the administration's approach has been a more traditionalist approach, opposing intervention, opposing a greater role for government in framing an ability to martial our resources to compete in the new international trade arena that we find ourselves in.

So that, until we all start modifying the basic economic philosophy that we're working from, so as to take into account the new reality—and the gentleman from Indiana talked about it very correctly—when we talk about protectionism versus free trade, it's an artificial distinction that doesn't exist. I think anyone who is sophisticated knows that we can't build a wall around the country and be totally self-sufficient. At the same time, I suspect you and everyone knows that free trade, in large measure, does not exist around the world.

So I think it's important that we start with the education process, to get rid of the rhetoric that we've talked about over the last number of years, and accept the fact that it's a new day, and there's going to be a need for a higher degree of public sector coordination.

Nobody is into, that I know of, picking winners and losers and all of the other rhetoric that we hear. But there is a need for a higher degree of governmental coordination to make sure that our industries are competitive in the world arena.

You mentioned telecommunications. There is no more productive, competitive industry that we have. And yet as you all know, our trade performance in this industry has not been good in the last number of years. My recollection is, last year we had a trade deficit of $700 million in telecommunications. This year, it's going to double, even though there is no one who makes the argument that we haven't got probably the most productive, the most competitive telecommunications industry in the world.

And the difficulty is some of the factors that commendably are addressed in the bill.

Let me touch upon some of the points that you raise on the bill.

Trade sanctions are a very important part of the bill. How does that square with the statements that have been made, even here today, that the overvalued dollar is the dominant factor in causing our trade imbalance?

If we do not address the overvalued dollar, is there any realistic hope of being able to use the trade sanction approach to compensate for the overvalued dollar?

I would ask any of the witnesses to respond.

Mr. **Samuel**. I have no answer, Mr. Chairman, but it seems to me that we do face, in effect, two kinds of problems. The long-term problems are those which this bill would address in reforming our trade laws.

Now the short-term problem is the problem of the dollar, and perhaps that could be best solved by some kind of a surcharge, which would take effect immediately and would help bring in adequate income to reduce the budget deficit, thereby hopefully reducing our interest rates, and thereby hopefully improving the parity of the dollar.

Mr. **Florio**. I notice that that was mentioned in the bill. Is that the position of the coalition, that a surcharge option to deal with the overvalued dollar is something that the President should consider, and if appropriate, implement?

Mr. **Samuel**. I am speaking now as an individual, not as a member of LICIT. LICIT has not dealt with this issue, and this bill does not deal with this issue directly.

Mr. **Wolff**. The bill does give additional authority to the President to impose an import surcharge, should that be in the national interest.

The current surcharge authority under the 1974 act is limited to 15 percent, which given the overvaluation of the dollar, which has been estimated at 25 to 50 percent, is wholly inadequate.

The bill would not require the imposition of a surcharge.

If I might follow up on what Mr. Samuel said, in addition, in something like telecommunications, the inflow into our country of telecommunications goods from abroad is certainly spurred by the overvalued dollar. However, our inability, our total inability to sell in Japan to NTT more than a minuscule amount of telecommunications goods, our total inability to sell to the Deutsche Bundespost in Germany and in Italy and in France, that has nothing to do with the exchange rate.

So the problems are really dual. We have a major problem with the overvaluation of the dollar. We have other areas of totally closed markets. You will hear this morning about natural resource subsidies. The overvaluation of the dollar certainly exacerbates the problems of our natural resource industries. But they would still have problems, even if the dollar were at a more rational value due to subsidies abroad.

So it's a combination of specific distortions abroad and the overvaluation of the dollar.

Mr. **Florio**. I think the specific distortions abroad are easier to understand and perhaps correct, if we have the will to correct them.

The overvalued dollar is not as easy to understand. Much of the discussion in the past has been on macroeconomic policy to reduce the deficits, bring interest rates down, and in that way deal with the overvalued dollar.

The difficulty, of course, is that even now, as we see that the deficits will be higher, even now when we see interest rates coming down, the dollar is still going up in value, which is putting into question some of the basic points that we have always worked from in trying to understand economics. This prompts me to point out, in your bill, when you talk about a negotiating objective of the

United States being to assist in establishing a new, multilateral exchange rate and payment system, which, of course, is a very interventionist approach which this administration does not support, if all of these macroeconomic concerns prove to be inadequate in terms of bringing down the dollar—and it may very well be, and Mr. Ritter and I were talking earlier—his point was that every time we have a highjacking, every time we have a bombing somewhere, the dollar is inclined to be stronger for security purposes, rather than any economic purposes, and he may very well be correct, and I think that is certainly a part of it—but if macroeconomic policies are not going to deal with it, is it my understanding that as one of your negotiating objectives, that the coalition is actively suggesting that we should become involved in exchange rate discussions and ranges of fluctuation similar to what the Common Market has done?

Mr. **Turner**. Mr. Chairman, the bill sets that out as an objective in any future international negotiations that may be pursued in the GATT; or this could be done in parallel negotiations to GATT discussions.

We don't have a particular formula. We don't feel that our financial expertise is really adequate to solve that problem.

We do know that a nonsystem has produced an inadequate result, and that efforts to reduce the Federal budget deficit alone may not be adequate to bring us down to an exchange rate that will reduce the overall level of our trade deficit.

But I think the feeling is very widely felt across the country that we can't look at the trade problem without at the same time also looking at the exchange rate problem. And that's why this bill has that negotiating objective and mandate, and that's why it also has the surcharge authority for the President, should the situation get so far out of hand that that kind of action is necessary.

Mr. **Florio**. Let me ask one last question and then yield to the gentleman from Indiana.

As was made reference to this committee and Congressman Wirth, this committee is working hard and trying to formulate the legislative response to the telecommunications problem that we have. The experience that we've seen is that it is not so much formal problems overseas, particularly in Japan but to a degree in other countries as well, it is not formal barriers that we have, it is informal barriers, in a sense—practices, customs—and that retaliatory action is not going to work, unless we start talking about certification denials, and we begin to measure results in terms of actual dollar market access on the part of our industry into overseas markets.

In the formal sanctions that you talk about in your legislation, what is it—what do you think, if you've given any thought to it, to making determinations about market access on the basis of bottom line dollar results, as opposed to advocating imposition of retaliatory actions with the hope that that is going to make access available to overseas markets, as contrasted with determinations on the percentage or the dollar value of market access?

Have you given any thought to that type of a measurement determiner?

Mr. **Wolff**. The action taken by the Congress in the provisions that you worked on so very much in the last days of the last Congress, the denial of fair and equitable market opportunities under section 301 as an actionable offense, it seems to me should be read in terms of actual results, exactly what you're saying. That is the way the law should be administered, if the United States is competitive.

Obviously, if we're not competitive in a particular area, that would not be a good measure. But you will hear this morning testimony on semiconductors, on natural resources, on fiber optics—a number of areas in which we're highly competitive—in which we're obviously not doing as well abroad in some countries as our competitiveness in other countries and the rest of the world would suggest.

Mr. **Florio**. The difficulty, of course, with the legislation we passed last year, that came out of this subcommittee, is that we gave the President discretion to call upon the appropriate agencies—the ICC, FCC—to deny certifications when determination was made that reciprocity was not available. But the fact of the course is, we haven't been able to force the President to use that discretion, notwithstanding the clear evidence that the reciprocity did not exist in some markets in some nations.

The suggestion is being made that somehow we ought to take the authority, and your bill provides for the creation of an administrative authority—presumptively the Trade Representative, the Department of Commerce, or someone.

What is it that makes anyone believe that that authority is going to act at variance to the predisposition or the preconceived thoughts of the administration?

There seems to be an implication here that somehow this administrative authority, which will be appointed by the President, delegated with the President's authority, is somehow going to make the decisions to enforce the sanctions that we're talking about when the President, or any administration, may not be inclined to do them.

How do you force action, even when the criteria specified in the statute has been met?

Mr. **Wolff**. I think the answer is, you cannot, but you can make it more likely that action would be taken. When the administration of countervailing duty and antidumping laws was shifted from Treasury to Commerce, that was a very great improvement in the administration of those laws.

Treasury never had an interest in enforcement of those laws. It never devoted the personnel or attention to the administration of those laws, and they were not well administered. Commerce has done a much better job.

If you gave to the Trade Representative or the Secretary of Commerce the administration of section 301, the ability to respond to foreign unfair trade practices, it would not be his primary concern to talk about base rights or to talk about foreign relations objectives in general. His concerns would be the trade interests of the United States. And while he could not ignore other factors that entered into the entire bilateral relationship between two countries, it would be more likely that trade would be his highest priority.

So I think that that would help move things in the right direction.

We also made mandatory certain actions when targeting is involved, for example, and where there has been massive deregulation in this country, such as in telecommunications, and the refusal of foreign countries to reciprocate.

Mr. **Florio**. Mr. Sharp.

Mr. **Sharp**. Thank you, Mr. Chairman. Let me, first of all, ask on the question of the overvalued dollar. We've discussed here several of the possible kinds of actions that may help us in reducing the Federal deficit, new multilateral system of exchange rates perhaps without any indication of exactly how that would work, but obviously there have been historically other possibilities that we've had in the past in this world besides the one we've got at the moment.

And third is the possibility of a surcharge imposition. Are there any others that come to mind? I'm not asking—I understand you folks are not recommending a specific course of action as a coalition on this, but are there other possibilities of action that the U.S. Government might take?

Mr. **Ong**. I might respond to that. All of the above is sometimes not a very attractive answer, intellectually, but I think in this area it is literally true that the problem has to be attacked at every level, and I agree with some of the chairman's observations on that point.

It is clear that macroeconomic factors do have a very great influence, and we need to continue to address the macroeconomic situation. The resolution of the budget crisis is bound to have a good effect, but when all is said and done, as Mr. Wolff said, we have the most attractive market in the world because it's the largest for almost all categories of goods, agricultural or industrial, and services. We also have the most attractive place to put money, and we can't deny that.

It is true that when international crisis of any variety anywhere in the world occurs, psychologically the reaction is to drive the value of the dollar up, the so-called "safe haven" argument. And I myself believe, and I think the members of LICIT broadly believe that that's a factor, and it's one that we're not likely to be able to influence. You can't change the minds of millions of people around the world as they make their individual market decisions about where to place their assets.

So I think——

Mr. **Sharp**. But we should, in fact, be proud of that.

Mr. **Ong**. I think yes, that's no reason for dismay. But I think it does, then, lead us to the other kinds of possible solutions; the possibility of encouraging, particularly in connection with the kinds of new GATT negotiations that we are recommending, the possibility of some reconsideration of multilateral exchange rate activity, that, after all, in a different environment and in a different world worked well for us for many years. It hasn't worked so well and has been pretty much abandoned at this point. That's not to say that it wouldn't be intelligent to renew some initiatives in that area.

Beyond that, I would also suggest that there are sometimes specific bilateral kinds of imbalances in exchange rates, and the bill before you obviously places great emphasis not only upon sanctions but upon bilateral negotiation and encouraging and facilitating that. And sometimes, that negotiation, in addition to trade practices, could also take exchange imbalances that have their roots in specific national policy elements into account. So I think that's another area to look at.

LICIT's view in this whole area is that the executive branch needs to have as many tools in its toolkit as it can possibly have. We don't view any one tool, if you will, as being the exclusive or predominant answer, but we think that we need to have a far greater array of tools and more flexible and more powerful tools, and then select the one that best fits the particular circumstance, whether it's bilateral or multilateral or whatever.

Mr. **Samuel**. May I add a word, Mr. Sharp? It seems to me that as you suggested in your question, we know what the tools are, really, to meet this problem. As John Ong indicated, this bill suggests a number of them but there are others that he hasn't even touched upon.

We don't have to invent any new wheels. All the wheels have been invented. What we do have to do is bring around to a higher level of awareness those Members in Congress and the leaders of our administration who simply refuse to face the facts. And unfortunately, their refusal to face the facts has led us into a very grim situation, the consequences of which are what has happened in your district with existing unemployment and prospective additional unemployment. And I don't know what kind of a 2 by 4 we need to get the attention of those folks who still refuse to face the facts. But hopefully through this bill we can put a little added impetus.

Mr. **Sharp**. Well, I hope you're right. I mean obviously, we can put all the arrows in the quiver that we want, but somebody has got to pull back the bow and be willing to shoot some of those arrows.

It strikes me that in addition to that—I mean, if I understand one of the central thrusts of that, it's to bring about some centralization and higher visibility within the governmental structure of the trade issue. Is there anything related to how we in Congress operate? What I'm thinking of is obviously, we make hundreds of decisions up here on regulation, on everything from transportation to tax policy, that has an impact on our competitive ability. And we've been doing that for years and years without even thinking about the possibility that it could have any impact on our international situation.

What I'm getting at is whether we need—I hate to see other rounds of bureaucracy, but we need some kind of trade impact statement on legislation, the way we have a budget impact statement which says that you're going to spend so much money over the next 5 years and you'd better understand that when you vote for this bill or you're going to lose so much revenue or whatever it is. And I'm wondering if we don't need something, or if this administration, in operation of this legislation with a more centralized authority, doesn't need to make it a high priority that in commenting on legislative proposals it comments on trade impact. I mean, that's something we can do without any new bureaucracy but it's something that it seems to me does not happen.

I don't know if you have any comment on that or have looked at this question.

Mr. Wolff. Mr. Congressman, clearly, had that been required, the deregulation of telecommunications would have not had the adverse impact it has had on American industry. The numbers of telecommunications companies in this country has dwindled as a result of the way we have handled our telecommunications industry in a vacuum, as if there were no international trading system. So that would be an extraordinarily useful addition.

What we do have in the bill is a requirement that the trade officials of government come to Congress annually with proposed sets of priorities for approval by the committees having jurisdiction, by vote. So that there would be priorities set, objectives understood, worked out between the Congress and the executive branch, instead of always, as we do today, dealing with problems on an ad hoc basis.

One congressman once said the trade problems aren't really like a—they don't show up suddenly. It's not that you look out your back window and there's a glacier in your backyard one morning. You know that they're coming. All you have to do really is sit down and think a bit about them in advance. And Congress and the executive branch don't work together in harmony to do that today. Our bill tries to correct that.

Mr. Sharp. Well, I think part of the positive thing that you've already indicated that's happening very clearly in the country is that while the British and the Japanese and some others have always understood how significant what was happening in the international economy was to their domestic economies, and therefore, just as a matter of from grade school up learning about this phenomenon so that it's impressed in everybody's values and minds whether they're in business, labor, or government. It seems to me that's beginning to change here.

I find very prominent people in agriculture and business in my own district who, a couple years ago, really kind of shrugged their shoulders at what was happening, who day after day become much more profoundly concerned about this. And I think that will lead us, hopefully, to a better approach to this international situation without just doing stupid things, which we had quite a capability of doing. Thank you.

Mr. Florio. Does the gentleman from Michigan seek recognition?

Mr. Dingell. I'd like to begin by commending you for holding hearings on the legislation now before our committee. I believe it's immensely valuable. And I think that Congress should act before U.S. trade problems, which are now approaching the most serious of magnitudes, worsen further.

I want to welcome Mr. Ong, Mr. Howard Samuel, Mr. Alan Wolff, Mr. Alan Coors, and Mr. Brian Turner to the committee. Gentlemen, you are a distinguished panel and we are honored to have you here with us this morning.

We are a debtor Nation now for the first time since 1914, and it is clear that the administration's unwillingness to develop a coherent trade policy to address the long-term economic interests of this Nation is at the heart of the problem. Since the administration appears to be loathe to apply existing trade laws and develop trade policies that will ensure fair treatment of U.S. firms and U.S. workers, the duty to absorb this important responsibility and carry it forward now falls to the Congress.

The legislation which we are considering, H.R. 1950, the Trade Law Modernization Act of 1985, is an excellent piece of legislation, and I would carry Mr. Samuel's anology one step further. one point of significance. He said it was not necessary to reinvent the wheel, and with that I concur. I think it would be nice, however, if we could get the administration to put the wheel on the vehicle so that we can commence moving forward.

Mr. Chairman, I commend you for your labors. It is a privilege to work with you on this matter. You are a distinguished member of this committee, and I certainly take pleasure in observing your leadership this morning.

Mr. **Florio**. Thank you very much.

Let me just make a couple of observations, and I thought it was particularly interesting to make reference to deregulation concerning telecommunications and perhaps there wasn't sufficient thought given to the international situation. We are now having some deregulation in the banking industry. It may very well be, and I think we're starting to see this particularly in regard to Japanese financial institutions, that we need to keep in mind the international banking situation and what will be the impact of deregulation in banking vis-a-vis the international situation. So at least maybe we can learn something from one experience that can be applied to another area.

I'm interested—and maybe Mr. Samuel could answer this—Congress passed legislation last year at the urging in large measure of the textile workers which led to the use of "crafted with pride in the U.S.A." as a logo on American-made textile products. I'm wondering—I mean, that has some cosmetic value—has anyone got any evidence yet that that has made any difference from the fact, other than just the therapy of it? Has it in fact resulted in any ability to compete on the part of our products?

Mr. **Samuel**. I can't answer factually, Mr. Chairman, as to whether there has been any effect yet. I think it's probably too soon to tell. I must say I think the leaders at least of the unions in that industry would be the first to agree that what is needed are far more significant and consequential approaches to the problem of unfair trade in the textile and apparel industry.

Mr. **Florio**. Let me ask one point. There's been some suggestion that if we deal with our macroeconomic problem—that things will get better. There has also been a suggestion that it is our growing economy that is, in a sense, ironically enough, fueling some of our problems, particularly the strong dollar.

Is there any value or is there any thought being given to advocating or considering policies of slowing down the economy, in order to deal with some of these concerns that grow directly out of the rapid economy? Has anyone given any thought or has your organization given any thought to that as an acceptable alternative? I know it's not something that one is comfortable about, but if the option is not going to result in any tangible results, which it doesn't appear to at this point, I'd be interested in anyone's observations.

Mr. Ong. Mr. Chairman, I think that it would clearly not be the view of our group—and I think I could speak for all of the companies and unions involved—to take that approach. We think that would be indeed a disastrous one.

Our orientation, our bias, if you will, is toward growth, and I would say not only in the United States but in the world. We think that the future security of all of us as human beings, whether we're Americans or whatever nationality, is bound up in continued, one would hope moderate, steady growth in the economy of the world as a whole. And obviously, the one great engine that will drive that growth, as it has driven it for centuries in the past, is world trade.

And it's exactly because of that conviction on the part of our members that we want to see the world trading system reformed at least to the degree that we can reform it by American initiative, because we're concerned that without that, the growing unfairness and imbalance in the trading system will lead, as it has oftentimes in the history of mankind, to the kind of protectionist reaction which, of course, kills growth, and the social and political consequences of that, I think history teaches us, are almost uniformly negative and harmful to society at large.

So we were pleased to see the economy grow, even though given the nature of the institutions that are involved in world trade, that aggravates some of the problems that are facing us. But we think the answer is to find structural solutions to those problems, not to try to brake growth.

Mr. Samuel. Could I add just one word to this discussion. The word, of course, is jobs. Our present economy has already left approximately 12 million people without jobs. If the economy were to slow down, that problem would obviously get worse, not better. And one of the problems causing that has been our inequitable trade situation.

So it seems to me the answer cannot lie in reducing the rate of growth of the economy, which would only aggravate the unemployment problem we already suffer.

Mr. Florio. Gentlemen, let me express my appreciation to you——

Mr. Sharp. Mr. Chairman, could I ask——

Mr. Florio. I'm sorry. The gentleman from Indiana.

Mr. Sharp. I'm sorry, I know you've got a lot of witnesses coming up and I don't mean to take more time, but I wonder if you could just briefly spend a few minutes on another tack on this thing. You talked about, Mr. Ong, the attractiveness of our market because of its size, penetration. Obviously, to come in from the outside as long as you've designed a product that's acceptable to American consumers and if you can cut your costs, you're in a pretty strong competitive position.

It strikes us that that's maybe a little easier than penetrating some of the other markets, even when they're open. And that may be one of our difficulties, and I wondered to what extent the Commission examined this question and has some specific recommendations, and to what extent LICIT has any recommendations on how and what our Government ought to do to assist the penetration abroad. Perhaps it doesn't take Government action.

But obviously, we have to have a cadre of people who can go out there and learn the regulations and the language and the skills, in hundreds—well, literally 100 different countries, if you're going to be involved there. That's more difficult to do, but the Japanese seem to go at it in a very aggressive way, and others do, too. And I wonder if the woodenheadedness—that we're only breaking out of that in lots of other ways in this economy in terms of an aggressive movement into these other markets. Which takes institutions and skill and drive and all kinds of things to do it. Did you folks address any of the specifics of that?

Mr. **Ong**. Speaking to the Commission on Industrial Competitiveness, that Commission did indeed address that problem, and that was one of the major areas in which my own committee worked. We made a number of proposals with regard to new forms of export promotion activity; an area in which the United States has traditionally been woefully weak. We also made a number of recommendations with regard to reorganization and revitalization of the executive branch apparatus for dealing with or assisting the U.S. private sector in its efforts to penetrate foreign markets.

Such things as making trade a high priority for our ambassadorial and ministerial delegations around the world. If you've spent much time traveling, and I'm sure you have, I'm certain you've observed that our embassies around the world are generally uninterested in trade and business matters as opposed to diplomatic, military and other kinds of considerations.

And also, to the point that you made, encouraging the executive branch to very greatly increase the capacity, both in terms of people and capability, of our staffs in foreign countries in order to provide a far more sophisticated and thorough-going analysis of what national policies or private sector policies in those countries represent in one way or another barriers to the entry of U.S. goods.

Our capability, I would suggest, to appreciate what the real nontariff barriers are and how they work is very, very limited. One of the reasons is that we have relatively few people in the public sector who have the language skills or the business sophistication to be able to make those kinds of assessments.

And moving away from the Commission and to LICIT, I would observe that, of course, an important element in the legislation you're considering is the expansion of that kind of research and development capability, if you will, to really understand how the markets work—the national markets work in other parts of the world—and use that knowledge to our competitive advantage.

Mr. **Sharp**. Those sound like important items. I was sort of thinking more in terms of private sector action. The reference was made to the cultural claims of the Japanese about buying Japanese rather than foreign. And I worry a little that maybe we Americans aren't getting off our butts and doing what you have to do. And that we've gotten it a little too easy and gotten a little too good and until this last couple recessions really hit people with a 2 by 4 it was just why not make it here after going to Harvard Business School instead of having to go out into the hot climate and set up a new market in a much more difficult environment. Not just physically but I mean socially and in every other way, where one doesn't always want to go and take a family and do all those kinds of things.

I'm talking about do we have the cadre of people, are we generating them out and are they being given prominence in our corporations, in our unions and other places where they are going to be out there researching that? Without those pioneers, we can just talk about all the stuff we want the U.S. Government to do, and it will help, but in the end, that's not what's going to make it.

What's going to make it is whether we have people out there beating the Secretary of Commerce to the punch, that they are already there ahead of and telling the Secretary of Commerce, hey, you should have been looking at this, we could have made a sale here but we didn't get the sale because you guys did nothing, instead of the Secretary of Commerce coming in and saying, well, we have got an open market but we've got nobody who wants to make a sale.

I'm not trying to put this on the backs of the private sector, I'm just asking are you comfortable with what is happening in the private sector?

Mr. **Ong**. Let me say I'm not going to speak as a representative of the management of private enterprise of the United States, but let me speak personally and respond to that.

Mr. **Sharp**. Sure. It's a very generalized thing, obviously, I'm talking about.

Mr. **Ong**. I personally feel there is much justice in what you say and that management bears some responsibility. When you look at the environment in which business management has operated in the post-World War II era, however, I don't think you will find that surprising. Once again, the sheer size of our national market is such that it has tended to preempt everybody's thinking.

But as I pointed out in my preliminary comments, the realities are changing greatly, both in terms of the amount of U.S. production that has to find a home outside this country and the amount of foreign production that is finding a home inside this country, and the market is the harsh taskmaster of managers. So if anybody had any illusions about their ability to ignore markets beyond the U.S. or things that are going on in those countries, I think those illusions are being stripped away very rapidly and have been stripped away.

It is fair to say that in some industries, and it has been uneven on a sectoral basis across the economy, there has been a long, honorable and fairly distinguished record of direct investment in other countries and major export activity, and we do have in American management today a fairly substantial cadre of veteran businessmen who have substantial experience in foreign trade, many of whom have spent years as expatriate employees representing their companies, who have good language skills and all those other things that so many people in our trading partner companies have and that we fail to possess to a considerable degree.

So I think the basis is there to do something, and I certainly would want to say that the members of LICIT by no means feel that the entire solution to our problems in this trade area and competitiveness area, and really we are talking about the same thing, lie with public sector initiative and activity.

We have our part to do as a part of the private sector. We have our responsibilities to be competitive and to stay competitive, and when all is said and done, those are probably at least as important, if not more so, than the totality of what our Government can do to support us. But our conviction is that the two efforts need to take place concurrently and, indeed, cooperatively.

Mr. **Sharp**. I still remain just a little worried about the notion that what happens is that because of the market realities, we are willing to learn as Americans how to go put a plant in Brazil and ship it back here, but what I'm concerned about is are we as willing to aggressively market, not just in Brazil but other countries, because my impression is that the sales end of it may be harder to do when you are trying to do that and to break into these markets. I may be dead wrong about that. It obviously would vary from product to product.

But you understand what I am saying, that the aggressive sales folks that are going to be out there making the sale abroad—and I understand. We are on the same wave length, I think, but I just worry that maybe we are going to find ourselves having missed out on a lot in that respect, too.

Mr. **Florio**. Would the gentleman yield just for an amplification on the point? We had a very good hearing a couple of months ago on chemicals and overseas production of chemicals. One of the interesting things brought to us from the chemical manufacturers was that in some instances, overseas sales were being reduced from domestic facilities because the facilities themselves, for a host of reasons, were being constructed overseas.

One of the reasons, and I think Brazil was one of the countries that was made reference to in terms of agricultural chemicals, fertilizers, things of that sort, was that the countries were insisting that if you were going to sell in the country, you were going to have to produce in the country.

Now, that sounds very much like domestic content, if I recall, and I think that the gentleman's concerns are particularly relevant to the concerns of Mr. Samuel and his constituents. It is nice to talk about being competitive overseas, but the difference between having our domestic company competitive in terms of selling overseas and its investment revenues coming back and producing here and selling the product overseas so that we have workers working on the products domestically is a very important distinction, I just, quite frankly, see that unfortunate scenario being the current scenario, that is, the company moving overseas, producing overseas, bringing revenue, perhaps, to the home base company back, but the job opportunities being reduced very substantially.

Thank the gentleman for yielding.

Mr. **Ong**. Mr. Chairman, if I might just respond to both those points very briefly.

Mr. **Florio**. Certainly.

Mr. **Ong**. Clearly this is a very complicated matter. There will always be some argument to be made for direct investment in manufacturing facilities in other countries, and obviously there are many countries which impose requirements of the kind, Mr. Chairman, you were referring to.

Contrariwise, there are countries which do not permit, or at least do not permit very flexibly or freely, direct investment by U.S. firms in manufacture in their national market. So we have problems on both sides.

I would suggest to you, however, that the base reason, perhaps, for the existence of our coalition is a feeling that if we had a more level playing field in world trade on balance, there would be a greater likelihood of the preservation of industrial production and industrial production jobs in the United States, and that that would be a benifit to all Americans.

There will always be some element of natural—I'll call it market force—type of direct investment by U.S. firms abroad. I think that's on balance healthy. I think what we are seeing now is an unhealthy, pathological requirement in many cases in many industries that forces U.S. firms to invest in manufacturing facilities outside the United States. When left to their own devices and without the kind of trade distortions that we have, they might very well make those capital decisions in terms of U.S. plant and equipment.

Mr. FLORIO. The gentleman from Pennsylvania.

Mr. RITTER. Thank you, Mr. Chairman.

I would like to associate myself with the remarks of my colleague from Indiana and New Jersey on this very issue. In some way, in a very real way, we are a captive of our historical background.

While the United States was the world's preeminent economy and then newly developed, we were a market for the goods from these developing nations. The whole philosophy behind helping them to develop was to invest American capital in these nations.

helping them to develop was to invest American capital in these

What has happened is we are still in that mode of operation. We are still operating under that momentum. That's what we know how to do. We know how to take General Motors and Ford all over the world investing in all these countries that prescribed domestic content as a prerequisite for doing business, and all of a sudden now, these countries are no longer underdeveloped, lesser developed, newly developed. They are flat out developed in those given industries in which we face competition, and yet we still operate under the same set of circumstances, those circumstances which we are accustomed to.

I think what it says is we almost need some fairly radical changes in our own policy—and I agree with the gentleman from Indiana—not just in the public sector but in the private sector, as well.

The level of aggressiveness across the length and breadth of American manufacturing, American services, American export industries, I think, has to increase. I think there are some great signs on the horizon. But let's face it: we are new kids on the block. We are new players in the game. These island nations and these basically coastal nations that had plants near ships, which were right in the water at the mouth of the productive facility, they have a big head start on us.

I think we have seen this pattern just in recent years. I understand the comments of my good chairman of the full committee in criticizing this administration, but I think we face a generic problem here. I don't think we face a problem of Carter administration versus Reagan administration; I think we face a problem that is four decades in the making. It's a post-World War II problem, and I think it's going to take a heck of an effort to solve it.

I just have a question before we head off to this vote. I'm just wondering how much of this building trade deficit is recoverable given some of the right changes in our own policies, Government and private sector. How much can we get back of these exported manufacturing jobs?

Does anyone want to take a crack at that?

Mr. **Samuel**. I wish we could answer that, Congressman. I'm not sure if that's possible. The crystal ball is very cloudy. If we could depend on Congress acting with total rationality and the administration also——

Mr. **Ritter**. That is expecting too much, though.

Mr. **Samuel**. I guess so, but those are your words, not mine. Then I think that probably we could recapture a substantial number of those jobs. But the time is growing very short, and as you know, it is often very difficult to reclaim a job once it has been lost to another country.

Mr. **Ritter**. I fear we are going to see a high dollar for a long time because although the deficit is large, the interest rates are coming down, and it doesn't seem to mean much to the value of the dollar. I think it's going to be with us. Every time an airplane is blown out of the sky and instability reigns with aggressive actions by other parties outside our border, the United States looks safer and safer.

The investment may not be that high in terms of return, but the return is expected and is expected over the long term.

Are we losing our—you hear conflicting reports that we are losing the manufacturing industries in the United States permanently abroad. What are your feelings? The chairman of B.F. Goodrich, let's hear what your thoughts are. I have heard corporate executives in certain industries say we definitely are losing it, there is no place for us here, we are going abroad, it's $1.25 over there and they work hard all day and they work 7 days a week.

What are your thoughts?

Mr. **Ong**. I think there is no question that in certain industries we have already lost a significant part of our productive capacity reacting to the realities of the market, and that is really very much what this bill is designed to do, is to create a U.S. trade policy that will give us a better chance in the private sector to unleash our capabilities to continue to compete in this market, our domestic market, but also to compete importantly on a fairer basis in exporting to other countries.

I think some of the more particular sectoral presentations you will hear later today will underscore the fact that the barriers to entry of our exports are a major part of the problem. We don't want to see imports to this country necessarily decline. We would like to see our exports go up and attack the trade deficit problem in that manner.

But have we lost ground? Yes, in many sectors seriously.

Mr. **Ritter**. Is it a generic manufacturing loss as opposed to an overall economic loss? Is it focused?

Mr. **Ong**. I'm talking just strictly in terms of basic volume capacity to manufacture various kinds of goods. There have been major reductions.

Mr. **Wolff**. Congressman Ritter, for every four jobs created in service industries in the last 2 years, one has been lost in manufacturing, so we have not recovered the peak in manufacturing employment that we had prerecession. We are lower now in total manufacturing employment than we were prior to the recession, and that is unlikely to change and it is worsening constantly.

So clearly, the U.S. consumption of manufactured goods is not declining. We have recovery. Our consumption is going up. Manufacturing employment in the United States has not recovered.

Mr. **Ritter**. Is that potentially a natural occurrence as the rest of the world learns how to manufacture and in some cases do better than us? Again, looking back, the initial part of my comment was that back at the end of World War II, we were one of the few people out there who were manufacturing. Today there are a lot of players on the block.

Mr. **Ong**. There are always and have always been and, I presume, always will be shifts in employment, and those are a natural part of the development of technology and changes in demand at the various levels in the economy where demand occurs. So the fact that there has been change is not in itself evidence that anything has gone wrong, and increased development in other countries will presumably over time naturally lead to some changes in employment in this country.

But I think our feeling at LICIT is that job losses and productive capacity losses in this country have been aggravated beyond what normal market forces would have required by the trading practices of some of our trading partner countries, and that it is these specific, in some cases targeted, kinds of policies that have to be reacted to by the public sector.

Mr. **Ritter**. I concur. In fact, I would hope that this country evolves its own strategy of manufacturing here for export abroad. I think the world market presents an incredibly rich challenge in addition to a potential danger of competition, and our skills in technology should be applied and we should have the kind of doors opened to us that have been open for years to some of these competitors.

I will certainly work with my chairman and this committee in doing whatever we can.

Mr. **Florio**. I thank the gentleman.

Let me express our appreciation to this panel for its participation this morning. It has been very valuable, and we look forward to working with you as the legislative process moves forward.

I thank the panel.

We have a vote, so we will take approximately a 10-minute recess.

Out of courtesy to all of our witnesses, we will call our next three witnesses, Mr. Houghton, Mr. Millian, and Mr. Misbrener, as a panel as soon as we reconvene.

[Brief recess.]

Mr. **Florio**. The subcommittee will kindly reconvene.

I ask Mr. Amory Houghton, chairman of the executive committee of Corning Glass Works and cochairman of the labor industry coalition for International Trade to come forward, as well as Kenneth Millian, vice president, corporate administration and director of Government Relations, W.R. Grace & Co., and Mr. Joseph Misbrener, president of the Oil, Chemical & Atomic Workers International Union.

I would ask the gentlemen to introduce their colleagues at the appropriate time. As with our other witnesses, your statements will be placed in the record in their entirety, and you may feel free to proceed as you see fit.

Mr. Houghton.

STATEMENTS OF AMORY HOUGHTON, JR., CHAIRMAN OF THE EXECUTIVE COMMITTEE, CORNING GLASS WORKS AND COCHAIRMAN, LABOR INDUSTRY COALITION FOR INTERNATIONAL TRADE; DAVID A. DUKE, SENIOR VICE PRESIDENT AND GENERAL MANAGER, TELECOMMUNICATIONS PRODUCTS DIVISION, CORNING GLASS WORKS; KENNETH Y. MILLIAN, ON BEHALF OF PETROCHEMICAL TRADE GROUP; AND JOSEPH MISBRENER, PRESIDENT, OIL, CHEMICAL & ATOMIC WORKERS INTERNATIONAL UNION, ACCOMPANIED BY NOLA HANCOCK, LEGISLATIVE DIRECTOR

Mr. **Houghton**. Thank you. Mr. Chairman, I am Amory Houghton, Jr., and I am an officer of the Corning Glass Works. I have been for many years.

Along side me is my associate, Dr. David Duke, who is in charge of our whole electronics, fiber optics, and telecommunications area. He will be talking after I, if that's all right by you.

I suppose the reason that I'm here at all is that, along with Howard Samuel, I am cochairman of the labor industry coalition for International Trade. I have been associated with that since it started. I'm very proud of it. It is not a Presidential Commission. It's not something which was pushed by the labor unions or by the business roundtable. It was a voluntary association of really interested people, who are not without a reasonable economic base.

For example, the companies and the unions represented in LICIT represent over 5 million workers. The sales of those companies are over $90 billion. We sell and operate plants in every single state and probably most of the countries, well over 100 countries, in the world.

I think our feeling, in addition to being able to talk and communicate and associate on an entirely different level than usually happens over the bargaining table, is that we have a single, a common focus. And, Mr. Chairman, I'm subjective about this. I don't pretend to be objective. But I believe it is the single most important issue facing our country.

I do not believe personally that it's the taxation issue. I do not believe it's the national deficit issue, because the trade issue, if it is not focused on and something done about it, which we have suggested here in this H.R. 1950, those jobs are gone, finished, done.

And I think if there's anything I can add to this proceeding this morning, Mr. Chairman, it's the human factor. You know all about the economic factor, and you know that in terms of the charts and the projections and the trends and the fact that we're looking at over $150 billion in terms of a trade deficit, you even know, I'm sure far better than I, those specific figures vis-a-vis Japan.

But I think that it seems to me that lost in all this process is what happens—some people call it jobs, and I just call it human beings—and the reason I feel strongly about that is that I happen to live in a small community in upstate New York where we know and our children go to school with and our wives are associated with those people who are, in a totality, our company. We don't have a research laboratory off in Palo Alto and a head office in New York City and plants in some other place. In microcosm, we are industrial America right up there in our little valley, and so we understand what happens.

And what I thought I would do, if I could, is just tell you the story of a particular plant of ours in the Chemung Valley.

Corning Glass Works is a company which is not in the takeover business. It is not a conglomerate. It is based upon the self-generation of its own internally produced technology. And we have a plant up there we call Pressware, and that plant has gone through four changes of life.

One, we produced Pyrex there, which was introduced a long time ago. I hope you have lots of this in your home. And then that was moved someplace else, and we produced black and white televisions. And then following that was color television, and then following that now is a brilliant, new glass counterpart of plywood called laminating, and the product we sell for the dinnerware market is called Corelle.

Black and white television was the single most important product line that we ever had in the company. It was absolutely ruined by the Japanese dumping, and the whole business left. We brought in color television. Exactly the same thing happened.

And how do you explain to people who do good work, who produce high quality, have the best service, the lowest cost, that they no longer have a job?

Now luckily we had a black and white to follow Pyrex or a color to follow black and white, and now a Corelle to follow the color television. But even Corelle is in trouble.

And let me show you some of the figures, which I think are sort of staggering, that I'm told—and I just checked this this morning—that we are, in Corning, NY, are the only remaining U.S. consumer dinnerware manufacturer to sell product at retail. All comes in from abroad.-We find ourselves—and this is primarily because of the difference in the dollar valuation—at a tremendous disadvantage.

So that organization, that plant has been cut in half in terms of employment, and I don't know what's going to happen to it. We're running at break even at this particular moment.

There are four very significant, brandnew technologies all developed by us, all producing a product which went into the U.S. market and captured almost overnight 25 percent of that business, and yet we're the only one remaining, and we're a break-even proposition, and we're not in good shape.

Now the reason for the story of that plant is that in two instances, there was unfair trade practices, which is primarily targeting. And it's the typical story. And Dr. Duke will tell you about what's happening in another product line.

We invented a product, we produced it, we sold it to customers, we shared it abroad, and then what happened? The people—in this particular case, Japan—wouldn't let a product in. I'll bet there are not 10,000 American television sets that have ever been sold in Japan, and 10,000 television sets from the Japanese into this market happens every day.

They combined their research activities. They had subsidies. They had a different price in Tokyo than they had in New York City.

It's always been incredible to me to see—and this is, to me, the failure of the GATT, that we can't sell a product of ours that we invented at a lower price and a better quality in Japan, while they can say anything they want and sell anything they want into our market. And if we did the same thing, because of the Robinson-Patman Act, we'd go to jail, and they don't, and they take a whole business away from us.

We had to close a plant in Bluffton, IN, that was producing color television, and I didn't know what to say to those people. And I got more wonderful letters from these people saying, you know, "We know you tried to the best you could, but there were conditions beyond your control."

And so I think, Mr. Chairman, in sum and substance, what I'm saying is that we can develop technology, we can invest, we can get good people, we can sell just as hard as we can, but we cannot protect against nations attacking individual companies like ours, because we do not have the means. And if we can protect our military system, if we can protect our schools, if we can protect our farms, why can't we protect our basic industries?

It's not that we're inefficient. I'm sure there are people who are inefficient. It's not that we have the highest prices. We just can't exist in a competitive atmosphere in which the rules we play by are Marquis of Queensberry, and the rules others play by may be kung-fu, and I just don't think that's fair.

And we can't control it. And as we look to the U.S. Government for help in terms of protecting us militarily, so must we look in terms of this type of economic protection.

Thank you very much.

[The prepared statement of Mr. Houghton, Jr. follows:]

Statement of

Amory Houghton, Jr.
Chairman, Executive Committee
Corning Glass Works
and
Co-Chairman
Labor Industry Coalition for International Trade

Good morning. I am Amory Houghton, Jr. and I am Chairman of the Executive Committee of Corning Glass Works and Co-chairman of the Labor Industry Coalition for International Trade (LICIT). I am before you today to discuss the need for reform of America's trade laws. I helped to establish LICIT in 1979. LICIT is a voluntary association of leaders representing two of the primary forces in the U.S. economy. LICIT's member unions and companies represent over 5 million American workers and account for over $90 billion in sales with operations in 50 states. Without reference to outdated slogans of "free trade" and "protectionism," LICIT supports open, fair competition for foreign products in the United States and for American made products in foreign markets.

Before discussing the need for reform of our trade laws, let me tell you about my company and its stake in the world economy. As of January 1, 1985, Corning employed over 30,000 persons engaged primarily in the manufacture and sale of products made from specialty glasses and related inorganic materials having the special properties of chemical stability, electrical and heat resistance, light transmission and mechanical strength.

From these speciality glasses, Corning produces, among other things, large quantities of individual electronic components including resisters and capaciters widely used in industrial, aerospace, military equipment, telecommunication devices, computers, missiles and radar. One such product, CORGUIDE optical wave guides of fibre/optics are thin glass strands through which communications data are transmitted by impulses of light.

Corning, and other producers of advanced technology in the United States manufacture the world's most sophisticated equipment in these fields. One reason we have been able to reach such advanced stages of production has been because of the benefits of an open world economy where other nations can purchase our goods for use in modernizing their infrastructures. Recently, however, the situation has changed dramatically. My colleague David Duke will describe our experience in trade in fibre optics with the Japanese as one example of unfair trade. You are familiar with the term "industrial targeting." I think our experience with targeting of fibre optics industries by Japan illustrates how damaging such practices can be. As a country, we must be in a position to respond to such practices where they cause injury to domestic industries.

The approach to international trade in this country has been based on the presumption that trade is governed fairly and effectively by existing international rules and domestic laws. However, for large segments of world trade, this presumption long ago ceased to be valid.

U.S. trade laws, and the international system established by the General Agreement on Tariffs and Trade (GATT), are outdated and inadequate. They are not capable of addressing many new trade distorting and injurious actions by foreign governments. These practices curtail U.S. exports, promote a surge of unfair imports into America and erode support and consensus for an open trading system.

Recent attempts to manage world trade -- in sectors ranging from consumer electronics to steel, automobiles, computers and telecommunications -- operate outside of the GATT rules and tend to make them irrelevant. All governments, including that of the United States, have participated in these arrangements.

The inadequacy of current U.S. trade laws and the declining relevance of the GATT as a regulator of world trade are very closely related. Present international trading rules were designed in the late 1940s primarily to address tariff barriers, which in the meantime have been substantially reduced. However, many other practices have since evolved that are not covered by international rules that distort trade as much as or more than traditional tariff barriers. Foreign government targeting, discriminatory government buying policies, subsidies by stateowned or state-controlled companies, and export performance requirements and countertrade requirements, can dramatically alter competitive opportunities, but they are not effectively restrained by the current international rules. A new framework of international rules is also required to bring discipline to these proliferating trade practices. Improved domestic laws and policies are needed to remedy the injurious effects these practices have on U.S. firms and workers.

The Trade Law Modernization Act (H.R. 1950) that has recently been introduced provides such a comprehensive review and updating of U.S. trade laws.

- It sets forth directions for future multilateral negotiations toward an improved framework for international trade, including a more stable exchange rate system.
- It establishes a fair basis for maintaining balanced access in the United States and abroad when U.S. regulatory actions unilaterally open up U.S. markets.
- The bill addresses the problems of injurious targeting and subsidized natural resources which have escaped any adequate treatment under current U.S. trade law and policy.
- It also brings the escape clause (Section 201) into harmony with established international standards, making relief from injury caused by imports more accessible, and provides greater opportunities for injured U.S. industries to use a period of import relief to enhance their competitiveness.

It may seem paradoxical, but only the successful pursuit of national economic self-interest will give the United States the means to keep its own trade open while enabling it to provide the leadership necessary to maintain an open the international trading system. There will be no willingness by other nations to follow the lead of a country that is not itself a strong competitor. Other countries will have no reason to negotiate new international rules unless it is in their self-interest to do so.

The reform of America's trade laws is thus doubly important, both for the economic well-being of the United States and for providing the means to achieve improved international rules.

Mr. FLORIO. Dr. Duke, did you want to make some comments?

STATEMENT OF DAVID A. DUKE

Mr. DUKE. Yes, Mr. Chairman, thank you.

As Mr. Houghton says, I am a senior vice president of Corning Glass Works and the general manager of our Telecommunications Products Division. I have been responsible for our fiber optics business in Corning for the past 9 years and have direct personal experience in trying to access a number of the domestic and international markets around the world.

My statement—much of the details are in the statement, and I will not, Mr. Chairman, spend time going through that, but I would like to hit a couple of high points.

I have personally found the access to the Japanese market the most difficult of any market in the world. We have been able to export optical fiber and to participate in every other major market in the world except Japan. I am convinced this is the result of targeting by the Japanese Government, with the classic and now familiar patterns of MITI designating it as a targeted industry, the funding of national projects, Nippon Telephone & Telegraph [NTI], picking traditional suppliers, protecting their markets, and et cetera—much of the detail which is in my written testimony.

I personally sat in a hot room in 1977 when an official from the Japanese Government got up and outlined what their plans were for the information age which would take place in the 1980's and 1990's, and particularly how fiber optics would fit into that. I remember walking out with some of my colleagues saying, "It's just like playing poker, and the person on the other side has just laid the cards on the table, and we're not quite sure how we're going to beat them because they're playing by different rules."

As a result of this targeting, legislation was passed which allowed companies to do joint research and development. NTT did joint R&D with three of their major suppliers. They did not allow other suppliers to participate. They did not allow United States or other foreign manufacturers to participate in their market.

I think the feelings of some of the Japanese at the time are reflected in my testimony. The head of one of our competitors in Japan basically said that Corning for many years has been trying to access that market and manufacture in the Japanese market and supply; however, in the mid-1970's when fiber optics were in the development stage, Corning was in such a strong position that they felt that this would not be to the benefit of the Japanese market, and as a result there was a decision to counter our strength.

As a result, there was joint R&D, there was a protected market, and now 10 years later, the Japanese are truly formidable competitors.

This has been my experience, that they, having done the joint R&D, they continued to pay prices which were several times that of the world market. They said all of the right words. I personally visited with NTT, the engineering people, and management. Mr. Houghton, Mr. Houghton's brother and I, have many times been to

Japan and talked to NTT and MITI and other people about how we could access that market.

As part of the bilateral trade agreements between the United States and NTT, there was supposed to be an opening up of trade, including purchases and at least options for purchases of U.S. telecommunications equipment. In several instances, these were, I think, grossly misleading. As I point out in my testimony, in one case they indicated that they were going to purchase a large amount of fiber optic cable. It was difficult to supply that, since we didn't have the specifications. In fact, it was a year and a half after we asked for them, that we were finally able to get the specifications for the product, so it's very difficult to sell something if you don't know exactly what it is that you're supposed to try and sell.

Significantly, from my standpoint, by the time we got the specifications, the requirements were such that to develop their type of product, the major backbone trunk system of fiber optics, which was put in from Hokkaido in the north to Kyushu in the south, was basically installed. There now is a bit of a problem with fiber optics manufacture in Japan, because the market is in a temporary lull.

In the meantime, they have used the high prices, the subsidy, in a sense, which was given to them by high prices and a protected market by NTT and the national projects to develop modern capacity—they have excess capacity substantially above that which is required in the Japanese market, and we now see the traditional drive for exports, not only to the United States but essentially all over the world.

And I personally find it very frustrating to try to compete in a world market where one aspect of that market, meaning Japan, is closed and the traditional targeting of an industry—the high prices, the protected market, the specifications, all the kinds of things which we've seen over the years in consumer electronics and machine tools, and we could just go through them—happen once again.

We are sitting now at the beginning, in a sense, of a very large, growing industry in optical communications with a protected market in Japan. We are not hurting yet, and yet as we look ahead, the potential for injury is there, and we're very concerned that we're going to have to wait until the patient is terminally ill before anything happens.

So I commend, Mr. Chairman, you and your committee for taking some direct action on a bill which will address targeting, as I and Corning have personally been involved in the fiber optic industry.

Thank you.

[Testimony resumes on p. 164.]

[The prepared statement of Dr. Duke follows:]

Statement of

David A. Duke

Senior Vice President and
General Manager of the
Telecommunications Products Division
Corning Glass Works

Good morning. I am David A. Duke, Senior Vice President and General Manager of the Telecommunications Products Division of Corning Glass Works, in Corning, New York. Corning is a leading manufacturer of specialized glass and glass-ceramic products. Among these products are optical waveguide fibers -- flexible hair-thin strands of ultrapure glass through which light rays may be directed from one point to another. Corning's research efforts in optical fiber began in 1966, and by the early 1970's Corning had made pioneering inventions and had been granted the basic U.S. patents in the field of optical fiber. Foreign patents corresponding to these U.S. patents were subsequently obtained. I have been responsible for the optical fiber business at Corning since 1976. I have been involved directly in Corning's domestic and international activities and have tried to gain access to the Japanese market for the past 9 years. I speak to you today from personal experience.

As Mr. Houghton has mentioned, I am before you today to describe Corning's experience in attempting to sell optical fiber to Japan. Access to the market for optical fiber in Japan has been the most difficult of any major country in the world. It is my opinion that the primary reason we have been prevented from selling to Japan has been that the Japanese have targeted fiber optics as one of the key technologies (of similar importance to computers, satellites and advanced semiconductors) for them to develop domestically as they make the transition from consumer electronics to the more advanced information technologies, including telecommunications by optical fiber. I was at an optical fiber conference in Tokyo the summer of 1977 when an official of MITI (Ministry of International Trade and Industry) outlined their vision for the future and the key role that fiber optics would play in making Japan a world leader in the 1980's - 1990's in the "Information Age".

As a targeted industry, the Japanese have successfully kept U.S. producers out of their fiber optic market while they worked to reach technical parity, with NTT providing Japanese optical fiber manufacturers subsidized R&D, virtually guaranteed procurement and procurement prices much higher than world prices. The Japanese Diet passed legislation in 1978 exempting Japanese manufacturers from antitrust concerns so that they could collaborate in the R&D of optical fiber manufacturing. NTT limited the development of fiber optic cable to three cable manufacturers who joined with NTT in joint R&D activities which I will explain further in just a moment. These companies have enjoyed a protected market for 10 years. I am now concerned that the next phase will be the characteristic export drive featuring high volume Japanese sales at prices lower than in the Japanese market. I will briefly discuss today Corning's experience in this area.

I. Joint Research and Development

In 1975 NTT (Nippon Telephone and Telegraph Corp.) designated optical communications as a priority area for its developmental efforts. To do so, it engaged in a series of joint R&D projects with the leading Japanese fiber optics producers for the development of fiber optics products and processes. For Optical fiber and cable, it limited the joint R&D to the three major copper cable manufacturers -- Sumitomo, Furukawa and Fujikura. The joint R&D was done with one of NTT's laboratories. At the same time NTT provided these producers with a virtually guaranteed market for their product when it was developed. From 1977 through 1984, NTT purchased all of its fiber optic cable requirements from these three companies. As stated in the August 8, 1981 edition of the Japan Economic Journal:

> "Sumitomo Electric Industries, Ltd., Furukawa Electric Co. and Fujikura Cable Works Ltd. are now running ahead of others on the strength of techniques that they have accumulated through a joint research and development project with the governmental Nippon Telephone and Telegraph Corp. (NTT). NTT will be by far the largest customer of optical fibers . . . The present leading position of the Big 3 owes largely to the joint R&D project with NTT.

More recently (and more pointedly), the February 1984 issue of the Japanese magazine Oriental Economist stated (on pg. 7) that in Japan "it would appear difficult for foreign companies to enter into basic optical fiber sales, because this is one of [Japan's] golden egg technologies." This has certainly been my experience. In 1976 I asked Furukawa Electric if it would purchase Corning's optical fibers which they would then cable and sell to NTT. We actually sold a few hundred kilometers to them in the mid 1970's. However, Furukawa told me that they needed to cooperate with NTT on the development of Japanese technology so that they did not intend to purchase in the future. When I asked if Corning could participate in a joint venture with Furukawa I was told that "NTT would not allow it." I raised the question of a joint venture several times from 1977 through 1983. Each time I was told by Furukawa that it would not be possible and NTT intended to purchase only from Japanese companies and that including Corning in a fiber optic venture would result in no purchases from NTT.

Mr. Masao Funihashi, President of Furukawa, in an interview with Nihon Keisai Shimbun on May 22, 1982 indicated that Corning's plan for local production of optical fiber is apparently its long-cherished desire. Furukawa's motivation of concluding a licensing agreement with Corning was that, at the time of the agreement, the optical fiber development race had just started, and Corning's capability was so overwhelming that there was a danger of Corning's dominance (of the Japanese market) if Corning was able to enter the market. Therefore, it was decided to counter Corning's plan. President Masao Funihashi explicitly said, "I have no intention of producing optical fiber jointly with Corning in Japan." This is because Japanese optical fiber technology has reached the top level in the world through the joint research and development system established between NTT and three companies, Furukawa, Sumitomo, and Fujikura, so that Furukawa feels they should not independently share the results through a JV with Corning.

Since NTT is a purchaser of fiber optic cable and Corning is a supplier of only the optical fiber, we require a cable company to purchase our fiber. Now in 1985, the key Japanese cablers all manufacture their own fiber and have told us they don't need to purchase fiber.

II. NTT Optical Fiber Procurement Policies

NTT procurement was supposedly opened for non Japanese suppliers in December, 1980 as part of a US-NTT agreement. On May 20, 1982, James Houghton (Corning's chief executive officer) and I met with Mr. Kitihara, the Vice President of NTT, and expresed our interest in becoming a supplier to NTT. We asked for the technical specifications so that we might develop a product to meet their needs. Mr. Kitihara responded that NTT now had an open door policy and "wanted the supply of the best product in the world at the lowest price." Our discussions were reported in the Nikkei Journal on May 21, 1982. It was not until February, 1983, that NTT provided Corning with any procurement specifications. However, later that year NTT informed Corning that these were only "target" specifications and that detailed specifications were proprietary to NTT and its suppliers.

In August of 1983, in a public notice of telecommunications equipment procurement, NTT listed 600 km of graded index optical fiber cable and 3,200 km of single mode optical fiber cable. (The single mode fiber cable is the newest technology and 80-90% of the installations in the world are now with single mode fiber.) This notice was very misleading, since this was for procurement of products which were open to bids by U.S. and other companies. It is very difficult to quote on a product if you don't know the product specifications! I met again with NTT and requested the specifications for both the single mode and graded index (multimode) fiber. However, we received only the specifications for the older multimode fiber type. It normally requires 1-1/2 to 2 years to develop a specific optical fiber to certain specifications, have it cabled and do the required testing. Since by that time the NTT requirements for multimode fiber cable would undoubtedly be quite small, we repeated our earlier requests to NTT for the predominant single mode specifications. Corning was finally told in December, 1983 that these single mode specifications were not yet available since it was still a developmental product. And yet at this time NTT was purchasing approximately $85 million of this single mode fiber cable -- hardly what would normally be called developmental. Corning finally received the single mode specifications in February, 1984.

Thus, it took Corning several years simply to secure the basic information needed to put Corning in a position to design a product to try to sell to NTT. It is interesting to note that the major demand for single mode fiber cable was the "backbone trunk" from the north to the south of Japan. This backbone trunk was completed in 1984. Since it normally takes over 12 months to develop a product and another year of testing, our inability to obtain the specifications precluded us from even bidding on this major project. However, even if we had been able to obtain the specifications, and after making a significant developmental effort, there is a question in my mind (based on past practice) if NTT would have ever seriously considered the resulting Corning product -- and we would not have had the advantage of the price subsidy which NTT has paid to its domestic suppliers over the past five or six years during the initial stages of optical fiber development.

III. Design vs. Performance Specifications

The NTT-US agreement clearly states that purchases by NTT are to be made on the basis of performance specifications and not design specifications. However, so far the NTT engineering bureau has evaluated only fiber optic cables which meet their design specifications, even if products which do not meet those particular specifications offer superior performance at a much lower price. These NTT design specifications were developed by NTT and their three domestic cable suppliers and are unlike those anywhere else in the world. The process to manufacture this specific cable is slower and more expensive than the processes used to manufacture cable in the U.S and Europe.

Ironically, NTT has indicated that over the next few years it will phase out its present design in favor of faster, lower cost cables. Thus, even if Corning were to decide to invest the time and resources needed to develop a product to meet current NTT design specifications, it may well be that within a few years the original design specifications would no longer have any commercial relevance.

IV. NTT Procurement Prices

NTT has purchased fiber optic cable at prices much higher than the "world price." From NTT public documents which state what they purchase and the value paid, I calculated that in 1983 NTT paid its Japanese suppliers approximately $2.40 per fiber meter in cabled form. The 1983 cable price in the U.S. for a comparable product ranged from 50 to 80 cents per fiber meter; or about 1/3 to 1/4 the prices paid by NTT. These prices were verified by market consultants who studied the Japanese market and by direct discussions I had with NTT. The Japanese Optoelectric Industry Technology and Development Association data also confirmed the prices and volumes of Japanese sales. Given the total volume procured by NTT in 1983 (45,600 km of fiber), this price differential between the NTT price and the market price resulted in a *de facto* subsidy to NTT's fiber cable suppliers in 1983 of $70 million. This subsidy allowed these suppliers to modernize equipment, do extensive R&D, and build capacity for projected export sales, while simultaneously competing at much lower prices around the world.

V. Japanese Capacity Expansion

Japanese producers of optical fiber have established production capacity far in excess of what is needed to supply the Japanese market -- that is, they are clearly planning a major export push. For example, for 1983 and 1984 Corning estimated that the entire Japanese fiber market was about 55 to 60 thousand kilometers. In 1985 this is expected to drop below 50,000 kilometers with the completion of the backbone trunk.

The actual production capacity of optical fibers in Japan is difficult to measure. This is due to the dependence of production capacity on the type of fiber manufactured and the selection rate of higher performance fiber. Japanese fiber manufacturers state very large capacities in the press. Sumitomo publicly announced that their capacity was 20,000 km per month or 240,000 per year. Furukawa and Fujikura have disclosed their capacities at between 20,000 and 10,000 per month. Hitachi Cable, Ltd., Showa Electric Wire and Cable Co. and Dainichi Nippon Cables Ltd., each have some manufacturing capacity to make fiber optic cable. If these were actual production figures, the capacity would exceed 600,000 kilometers each year. I'm sure that these numbers are highly overstated, but it is still far greater than the demand of 50-60,000 kilometers requred in Japan.

VI. U.S. Government Response

On several occasions during the past few years the above issues have been raised with the Japanese during meetings of the government-to-government High Technology Work Group. Both the Office of the Special Trade Representative and Department of Commerce represent the U.S. on this Work Group, and have been diligent in discussing these concerns during sessions of the Work Group. However, so far the Japanese have not felt a need to change their behavior.

On April 18, 1985, the International Trade Commission upheld the decision of the administrative law judge in Corning's Section 337 (patent infringement) complaint before the I.T.C. alleging unfair practices in the importation and sale of certain optical fiber by Sumitomo. The decision provided that although the applicable Corning patents were being infringed by the Sumitomo fiber, there was no Section 337 violation since the I.T.C. determined that "Sumitomo's imports did not have the effect or tendency to destroy or substantially injure" the relevant domestic industries. Thus, Corning finds itself in the unfortunate position of having its patents infringed by Sumitomo imported optical fiber and yet being denied a corresponding remedy by the I.T.C. Corning is now pursuing a patent infringement action against Sumitomo in federal district court, but this is a time-consuming procedure.

I find it ironic that Japan can target the U.S. fiber optic industry, protect its home market for 10 years while paying prices substantially above world prices and then export to the wide open U.S. market. Our laws and procedures only allow for remedies after the damage to an industry has been done or if the tendency to injury can be clearly shown. This emphasizes the need for the federal statutory remedy against the type of Japanese actions described above, which is contained in the targeting provisions of the recently introduced Trade Law Modernization Act (H.R. 1950).

If I can add any further information to what I have said today, I would of course be happy to do so. Thank you.

Mr. **Florio**. Thank you very much.

Mr. Millian.

STATEMENT OF KENNETH Y. MILLIAN

Mr. **Millian**. Mr. Chairman, I am Kenneth Millian, vice president, corporate administration and director of Government relations for W.R. Grace & Co. and I am here this morning as a representative of the industry side of the Petrochemical Trade Group [PTG].

Mr. Misbrener, president of the Oil, Chemical & Atomic Workers International Union is co-chairman of PTG and will be speaking following me.

We certainly appreciate the opportunity to talk this morning about what we see as a major problem in international trade—the State ownership and control of natural resources. In our view, this is a new form of export subsidy.

I will be examining today the ammonia problem, which we think is a microcosm of a much broader problem in the petrochemical area. I will summarize my remarks and ask that the full text of my written statement be entered for the record. And I also ask that additional items referred to in my prepared remarks—for example, the colloquy last year between Chairman Dingell and Chairman Gibbons, during the debate on the natural resource provision in the bill that passed last year by a bipartisan strong majority, also be included in the record.

Ammonia is produced by combining natural gas and air in a catalytic process.

Seventy percent of the cost of ammonia is natural gas. U.S. natural gas costs have increased tenfold since 1973. That year, the OPEC cartel initiated a change in crude oil pricing, moving the world from cost-based energy pricing to commodity value pricing. In the aftermath of this move, State-controlled energy companies began to move more aggressively into downstream production of value-added, energy-intensive products for export.

For example, Mr. Chairman, in 1970 governments controlled 40 percent of world ammonia production; today, governments control almost 70 percent. In our view, the goal of a government in this field is different than a business. Our trade laws have not kept up with our natural energy policies and worldwide commodity valuation of energy resources.

U.S. energy-intensive industries have, for several years, paid market clearing prices for natural gas. However, some of our major foreign competitors, primarily energy-producing governments, have created sovereign monopolies that own and produce their nation's energy supply. They set low prices for internal consumption while exporting energy at the higher commodity values set in the world marketplace. They own and operate the downstream petrochemical plants and refineries which use energy feedstock. They control domestic and export marketing of their products. Their ammonia and urea exports are produced at lower operating rates in higher cost, less sufficient plants.

The ammonia is transported over long distances to reach our market. For example, from the Soviet Union, 7,000 miles. Yet, ammonia has been sold here in the United States at prices below the cost of the natural gas input, which is paid by the U.S. producer. In other words, they're bringing that product into the market at less than it costs us to buy the natural gas to begin to make the product in our $400 million plants.

When sovereign monopolies sell themselves energy at prices far below market value, the practice should be recognized as a subsidy when their downstream products enter the world marketplace. Governments that choose to act like businesses should be treated like businesses, and play by the same rules as we do in the marketplace.

We do not assert that natural gas may necessarily cost the same in every world market. Unlike crude oil, it cannot be competitively transported except by pipeline. The fair market value of natural gas is better established by looking at conditions in the producing country's market, and that country's access to natural gas export markets.

The addition of new export capacity and trade barriers established by some governments can divert more ammonia and urea products toward the U.S. market. We believe that many government ammonia producers will continue to operate at the highest possible level regardless of demand. Some of these plants are simply not economic unless the natural gas or other energy feedstock is subsidized. Without these subsidies, such plants would have to curtail production in order to compete with fairly-traded exports.

Government practices can distort investment decisions for new petrochemical capacity. The World Bank, the United Nation's Food and Agricultural Organization and the American Gas Association have all analyzed world ammonia production costs. These analyses indicate that the U.S. is perhaps, interestingly, the best location in the free world for the construction of new ammonia capacity.

Lower construction costs, higher efficiency and direct access to the U.S. market offset the advantage of building new capacity to exploit low-cost gas in remote and less-developed countries.

However, under the threat of subsidized import price depression, the U.S. industry is not expanding and has no plans to expand.

In a yet to be published study done by the Department of Commerce, one Southeast Asian nation is in the process of building a methylene plant which, forgetting the cost, if you set the cost of natural gas into that plant at zero, they will be able to sell that product at 43 cents a pound break even into our Gulf Coast, when the current market price, the spot price, is 23 cents.

Now, our view is that that's not a business decision to build a plant and have that negative spread between what it's costing them and what the market is paying in the United States.

The countries that are among major industry subsidizers are Mexico and the Soviet Union in the case of ammonia, and Mexico, the Soviet Union, East Germany, Romania, Venezuela, and Brazil in urea. Urea is a follow-on product from ammonia. It's the stuff that you can drop into your garden by hand; it isn't put in the ground under pressure.

The efficient American farmer has come to depend on the assured availability of nitrogen fertilizers to achieve high yields. We should not mislead ourselves, however, into thinking that the U.S. farmer or consumer somehow can benefit by foreign-subsidized fertilizer imports.

In 1982 and during the farm PIK Program in 1983, U.S. producers permanently shut down over 2 million tons of ammonia capacity because of the drop in the market. Production in remaining plants was drastically reduced. During this same period, the Mexican and Soviet imports increased. When demand increased in 1984 after the PIK Program, the subsidized producers immediately raised their prices from $120 a ton to $180 a ton. In our view, that's not an assured supply of cheap ammonia.

The petrochemical trade group which we represent thanks you, Mr. Chairman, for focusing on the State-ownership and control of natural resources which we see as a new subsidy in the marketplace. We support, as you do, the Trade Law Modernization Act of 1985 introduced by Representatives Duncan and Guarini, which contains the natural resource subsidy provision. In addition, we support the natural resource subsidy bills introduced by Representatives Sam Gibbons, H.R. 2451, Chairman of the Trade Subcommittee of Ways and Means, and by Representative Henson Moore, H.R. 2345.

While some differences exist in these bills, they all recognize that discriminatory, below market energy pricing by governments is an unfair, upstream subsidy that distorts trade and disrupts the U.S. marketplace. It is causing shutdowns and decreased production for more efficient and competitive energy-intensive industries in the United States.

In closing, Mr. Chairman, I'd like to point out that these shutdowns are both unnecessary and avoidable. They will occur only if our trade laws continue to treat world trade in energy and energy-intensive products as if nothing had changed in the last 10 years.

The better option, in our view, is to modernize our trade laws in a manner consistent with our energy policy and in the marketplace.

Thank you. I'd be glad to answer any questions you may have.

[Testimony resumes on p. 214.]

[The prepared statement of Mr. Millian follows:]

Statement of Kenneth Y. Millian
on behalf of
The Petrochemical Trade Group
before the
Subcommittee on Commerce, Transportation and Tourism
Committee on Energy and Commerce
U.S. House of Representatives

June 26, 1985

Mr. Chairman and Members of the Subcommittee:

I am Kenneth Y. Millian, Vice President, Corporate Administration and Director of Government Relations for W. R. Grace & Co. I am testifying on behalf of W. R. Grace & Co. as a member of the Petrochemical Trade Group, a coalition of major domestic ammonia producers and unions. We are concerned with both the cause and effect of increasing imports of subsidized ammonia and derivatives, basic petrochemicals, refined petroleum products, and other energy-intensive commodities from government-controlled producers. Such imports are causing the decline of the U.S. fertilizer, petrochemical and refining industries.

Ammonia is produced by combining natural gas and air in a catalytic process. U.S. natural gas costs have increased ten-fold since 1973. That year marked a significant change in the valuation of energy resources by individual nations and worldwide. The OPEC cartel initiated a change in crude oil pricing, moving the world from cost-based energy pricing to commodity value pricing. In the aftermath of this move, nationalized energy organizations began to move more aggressively into downstream production of value-added, energy-intensive products for export. For example, in 1970, governments controlled about 40 percent of world ammonia production. Governments now control almost 70 percent. A similar shift has occured in the ownership and production of urea, a widely-traded nitrogen fertilizer made from ammonia.

The Natural Gas Policy Act of 1978 initiated the change of U.S. natural gas price regulation from a cost basis to a commodity value basis. In January 1981, U.S. oil prices were decontrolled. Shortly thereafter, world energy prices peaked and started falling. U.S. natural gas prices began to fall below NGPA price ceilings as market forces exerted increasing dominance over industrial natural gas pricing. The decontrol of most U.S. natural gas in January of 1985 signals the U.S. Government's continuing commitment to rely primarily on the marketplace to price energy.

However, our trade laws have not kept up with our national energy policies and the worldwide commodity valuation of energy resources. U.S. energy-intensive industries have, for several years, paid market clearing prices for natural gas. The same is generally true for Europe and Japan with regard to natural gas and refined petroleum products. However, some of our major foreign competitors have taken a different approach. These competitors are, primarily, governments. They have created sovereign monopolies that own and produce their nations' energy supplies, and set low prices for internal consumption while exporting energy at the higher commodity values set in world markets. They own and operate the downstream petrochemical plants and refineries which use energy feedstocks. They control domestic and export marketing of their products. Their ammonia and urea exports are produced at lower operating rates in higher cost, less efficient plants which are then transported over long distances to reach our market. Yet it has been sold here at prices below the cost of the natural gas input alone paid by U.S. producers.

When sovereign monopolies sell themselves energy at prices which are above its production cost, but below its fair market value, the practice should be recognized as a subsidy when their downstream products enter world trade. Sovereign monopolies should compete on the same terms when they manufacture and export downstream products like ammonia and urea. Governments that choose to act like businesses should be treated like business and play by the same rules in the marketplace. They cannot be made exempt because they are also governments. They can do anything they want in their own country, but they have to play by the same rules as the rest of us in international trade or when they enter U.S. markets.

Our trade laws must also recognize another related and significant problem -- that government energy and petrochemical monopolies can simply absorb differences in feedstock costs as necessary to achieve export market penetration. For instance, gasoline imports to the U.S. market have been sold for less than the posted and spot prices of the crude oil used to produce gasoline. The same kind of problem confronts petrochemical producers. For example, there is no direct sale of natural gas in the Petroleos Mexicanos (PEMEX) monopoly chain from the gas production unit to the ammonia production unit. There is only a paper transfer price inferred under U.S. trade law.

Mr. Chairman, I want to make it clear that we have no objection to a government maintaining low internal energy prices to encourage domestic development. We object only when governments export their domestic subsidies into our market and disrupt it.

Neither do we assert that natural gas must necessarily cost the same in every world market. Unlike crude oil, it cannot be competitively transported today except by pipeline. The fair market value of natural gas is better established by looking at conditions in the producing country's market and that country's access to natural gas export markets. Buyers both in that country and other countries make up the total market. That market will not set different prices internally and externally if it is allowed to function. U.S. natural gas markets will basically set the price of gas exported from Canada and Mexico, for example. The U.S. gas market will not set gas prices in Europe for gas exported from the Soviet Union. The fair market value of gas from Saudi Arabia or Trinidad will probably not be equal to U.S. prices. The key is the accessibility to the marketplace to export the natural resource. If a country does not have such access, then the value of its gas should be one which allows recovery of fully allocated costs, including a commercially reasonable return on investment.

Mexico's internal natural gas price to industry is now the equivalent of $1.62/mcf. This is a delivered price anywhere in Mexico, regardless of the distance from production sites. PEMEX and industry use about 90 percent of all Mexican natural gas. Mexican natural gas exports to the United States have ceased because Mexico will not export gas for less than $4.40/mcf to the United States. The Soviet Union reportedly exports natural gas through European pipelines for between $4 and $5 per mcf, but sells to its own industry at very low prices. Trade press has reported that gas is sold at the equivalent of $2 per mcf to Soviet industry, but netback analysis of the sales price of Soviet ammonia in the U.S. market has yielded much lower gas input prices -- even zero or negative values.

The Administration and Canada have renegotiated the border price of Canadian natural gas exports. The old system of linking gas prices to the price of imported oil to Canada's Eastern provinces artificially reduced Canada's ability to export its gas to the U.S. market. Canadian government projections reported by DOE indicate gas prices in the range of $3.09 per mcf in the Midwest to $3.50 per mcf in the Northwest. Industry sources report delivered gas sales in this price range and below. At these prices, Canadian gas is competitive with U.S. gas. The Canadian government is now engaged in the process of moving its internal gas prices towards market pricing. The Canadian policy revision serves the interests of consumers and industry in both Canada and the United States, in sharp contrast to the policy of Mexico.

We understand that natural gas in Saudi Arabia is now priced at about $.50 per mcf. That may represent fair market value today if all other contract terms are commercially reasonable. Before plants were built to utilize Saudi gas, Saudi Arabia had been forced to flare over a trillion feet of gas annually because it has no export market for its gas except as petrochemicals or LNG. It is our understanding that Saudi Arabia has committed most of its associated gas at current oil production levels to petrochemical plants, oil refineries and other industrial plants. Gas sales and prices may therefore be different under the fair market value standard in the future.

In addition to ammonia, we are beginning to see rapidly increasing imports of urea from the Soviet Union and its COMECON allies. Unlike ammonia, it is a solid product that can be applied by hand. In 1981, urea imports from the Soviet Union were zero. By 1984 they exceeded 400,000 tons. Urea imports from Romania and East Germany amounted to less than 16,000 tons in 1981. In 1984 they exceeded 414,000 tons. Most Soviet ammonia and urea enter our market on a countertrade deal with a single U.S. international oil company. However, a major international grain trading company is now apparently importing Eastern European urea, ammonium nitrate and nitrogen solutions, some of it reportedly under countertrades.

These government practices distort investment decisions for new petrochemical capacity. The World Bank, the United Nations Food and Agriculture Organization and the American Gas Association have analyzed world ammonia production costs. Their analyses indicate that the United States is perhaps the best location in the Free World for the construction of new ammonia capacity. Lower construction costs, lower labor costs, higher efficiency and direct access to the U.S. market offset the advantage of building new capacity to exploit low-cost gas in remote and less developed country locations. These analyses demonstrate that a comparative advantage in natural gas supply does not automatically translate into a comparative advantage to produce and export petrochemicals. However, under the threat of subsidized import price depression, the U.S. industry is not expanding and has no plans to expand.

Ammonia and urea plants are being added in other nations. Mr. Chairman, I emphasize that the Petrochemical Trade Group certainly does not oppose the expansion of fertilizer capacity worldwide or import competition. Private producers are expected to add capacity in Canada and Trinidad. Imports from these countries and other countries have provided fair competition in the U.S. marketplace and have proven to be assured sources of supply. They have not undercut and depressed U.S. prices. Gas prices are negotiated at arm's length in Trinidad. Canada has maintained two-tier gas pricing, but Canadian ammonia producers have not undercut U.S. prices of ammonia and injured U.S. producers.

The addition of this new export capacity and trade barriers established by some governments can divert more ammonia and urea exports toward the U.S. market, unless some foreign export producers adjust their production in keeping with export market demand. We believe that many government ammonia producers will continue to operate at the highest possible levels regardless of demand. Some of these plants are simply not economic unless the natural gas or other energy feedstock is subsidized. Without these subsidies, such plants would have to curtail production in order to compete with fairly-traded exports.

The efficient American farmer has come to depend on the assured availability of nitrogen fertilizers to achieve high yields. The Fertilizer Institute estimates that between 30 and 40 percent of total U.S. food and fiber production results from the application of fertilizers -- nitrogen, phosphates and potash. Use of nitrogen fertilizers by our farmers roughly equals the combined use of phosphate and potash fertilizers.

We should not mislead ourselves into thinking that U.S. farmers or consumers somehow benefit from foreign subsidized fertilizer imports. In 1982 and during the farm PIK program in 1983, when demand for ammonia fell as a function of reduced farm demand for nitrogen fertilizer, U.S. producers permanently closed down over two million tons of ammonia capacity. Production at remaining plants was drastically reduced. During this period in 1982 and 1983, Mexican and Soviet imports increased. This experience demonstrated that there is no effective marketplace constraint on the volume of exports of government-owned and subsidized ammonia producers into the U.S. market. The foreign government producers could easily continue to penetrate the depressed U.S. market because of their artificially low gas costs. When demand increased in 1984 after the PIK program, the subsidized producers immediately raised their prices from $120 a ton to $180 a ton. Mexico has cut back exports. In these circumstances, they can hardly argue that they provide cheap, assured supplies of ammonia and urea to U.S. farmers.

We supported the Natural Resource Subsidy provision in H.R. 4784 last year. The provision was passed by a large bipartisan majority in the House. Administration opposition defeated the provision -- by a single Senate conferee vote -- in the Trade Conference. The Administration apparently misunderstood, and certainly misstated, both the intent and the effect of the provision. The Administration repeatedly acknowledged that the natural resource issue posed a serious problem for U.S. companies. Yet they objected to the provision without offering a better solution. This year the Administration has even more clearly testified that this is a serious problem and is willing to work to find a mutually acceptable provision to the Congress, the Administration, our trading partners and presumably the U.S. industries involved. They oppose these amendments to the countervailing duty law on the single basis that they believe it violates the GATT.

Without going into great detail, the argument is based on a specificity test or general availability test created by the Department of Commerce, not the Subsidies Code of the GATT. The Department's position that this is the sole and absolute determinant of countervailability of domestic subsidies is clearly not supported by the GATT Subsidies Code and produces absurd results. For example, in the final determination in the CVD case on Mexican ammonia, the Department ruled that natural gas provided at very low internal prices was not countervailable because it was made available to all industries in Mexico at that low government set price. The absurdity was that the government set price was below the government's production cost even valuing the gas at the wellhead as zero. At the time, Mexico was selling gas to the United States at $4.40 per mcf. There is no way such an absurd result can be justified under the GATT or any economic theory of trade advantage. Attached to our testimony as Appendices A and B are a letter and memorandum from trade law experts and the key U.S. negotiator outlining the intended coverage of the GATT Subsidies Code, which refute the Administration's position.

The Administration appears to be using this construction and interpretation simply to limit unduly the application of U.S. countervailable duty law to avoid disputes with some of our trading partners using these unfair practices. What the Administration is really objecting to is the potential reaction of other countries and the possible uncertainties passage of this legislation will produce. Our response is the Administration has only itself to blame for its ill-advised, absurd, and patently unfair decisions in the series of cases under current law that spawned this legislation. Their actions demonstrate that the only avenue of appeal remaining for energy-intensive industries is the Congress.

We want to make it clear that the Administration's recent bilateral subsidy agreement with Mexico does not correct this major energy subsidy problem, even with Mexico. This agreement is bad precedent. It does not address Mexico's energy pricing policy or its other restrictive trade practices that increase exports and restrict imports of products like ammonia.

Chairman Dingell expressed concern during debate on H.R. 4784 last year whether the natural resource subsidy provision would affect U.S. natural gas price regulation or hydroelectric power generated in facilities owned by TVA and Bonneville Power Authority. First, government regulation of the price of natural gas per se is not a subsidy. It is a subsidy only if it would be regulated below its market value in a discriminatory fashion; in other words, if we don't sell it to everyone at the same price. Chairman Dingell and Chairman Gibbons engaged in a colloquy during the debate on H.R. 4784 on July 26, 1984. That colloquy appears at page H7911 of the Congressional Record of July 26, 1984, and we ask that it be made a part of the record of this hearing.

In addition, the late Congressman from Louisiana, Gillis Long, introduced in that debate a letter that he wrote to Mr. Robert E. Cole of Kaiser Aluminum discussing hydroelectric power and the fact that electricity is not a natural resource under the bill. That record appears at pages H7916-7918 of the Congressional Record of July 26, 1984. We ask that that portion of the Congressional Record also be made a part of this hearing.

Finally, I wrote a letter to the Deputy Under Secretary of Commerce, Mr. Olin Wethington, on May 29, 1984, addressing Administration concerns in this same regard. I attached to that letter a study conducted by Dr. Margo Thorning reviewing natural gas prices under the NGPA and the fact that the natural resource subsidy provision would not treat such pricing policies as a subsidy. That letter and Dr. Thorning's study are attached to my testimony as Appendices C and D, and I request that they be made a part of this hearing record.

The Petrochemical Trade Group supports the Trade Law Modernization Act of 1985 (H.R. 1950), introduced by Representatives Duncan and Guarini, which contains the Natural Resource Subsidy provision. In addition, we support the natural resource subsidy bills introduced by Representative Sam Gibbons (H.R. 2451), Chairman of the Trade Subcommittee of the Ways and Means Committee, and by Representative Henson Moore (H.R. 2345). While some differences exist in these three bills, they all recognize that discriminatory, below-market energy pricing by governments is an unfair upstream subsidy that distorts trade and disrupts the U.S. marketplace. It is causing shutdowns and decreased production from more efficient and competitive energy-intensive industries in the United States.

Importantly, the bills share three criteria to identify this unfair subsidy: first, whether a government entity provides the resource to itself or its domestic industry at less than market value; second, whether the resource is available for export to competing U.S. producers at the same domestic price without discrimination; and third, whether the resource, at its market value, constitutes a significant portion of the production cost of the product. Establishing such criteria in the trade laws would undo the unfair advantage enjoyed by government-owned and supported producers exporting such subsidized energy-intensive products to the United States market.

The continuation of discriminatory energy pricing policies by some energy producing countries to promote their own exports and protect their domestic industries will have a predictable result. It will cause the loss of more efficient U.S. industries to government-assisted competitors fueled by below-market priced energy inputs. The better option is to modernize our trade laws in a manner consistent with our energy policy and the marketplace.

For domestic social and political reasons, the foreign governments that now subsidize their fertilizer producers, refiners or other energy-intensive industries are very likely to try to shift the shutdown burden to other world producers. If the subsidies are continued, shutdowns will occur among more efficient producers operating in the United States. Mr. Chairman, these shutdowns are both unnecessary and avoidable; they will occur only if our trade laws continue to treat world trade in energy and energy-intensive products as if nothing had changed in the last 10 years.

Thank you. We would be pleased to answer any questions you may have.

U.S. AMMONIA IMPORTS BY SUPPLIER
1981 - 1984
(short tons N)

COUNTRY	1981	1982	1983	1984
Canada	400,714	476,195	641,111	750,610
Mexico	371,525	499,510	472,101	268,395
Trinidad and Tobago	291,529	238,942	439,418	611,563
French West Indies	7,720	7,778	57,203	33,854
Netherlands Antilles	7,377	19,569	-	-
Venezuela	-	17,137	23,303	41,722
Brazil	-	-	-	53,454
Columbia	-	-	7,477	-
Bahamas	-	-	343	183
Dominican Republic	-	-	-	4,302
Chile	-	-	-	2,625
Jamaica	-	-	-	40
Total Latin America	678,151	782,936	999,845	1,016,138
Netherlands	1	-	-	7,238
France	-	5	-	-
W. Germany	-	-	-	5,430
Total West Europe	1	5	-	12,668
Total Mid East	-	-	-	16*
Total Far East	-	-	1	-
Total Oceania	-	-	-	-
Total Africa	-	-	-	-
Total East Europe	-	-	-	-
U.S.S.R.	653,806	496,339	527,486	683,884
TOTAL WORLD	1,732,672	1,755,475	2,168,443	2,463,316

Note: Source is ACG, W.R. Grace & Co., Charts at 1-14-85, using U.S. Department of Commerce data for calendar years.

*From Jordan.

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U.S. UREA IMPORTS BY SUPPLIER
1981 - 1984
(short tons N)

COUNTRY	1981	1982	1983	1984
Canada	300,233	286,097	352,146	358,730
Trinidad/Tobago	8,025	13,593	3,926	7,592
Venezuela	3,073	5,831	66,586	36,049
Mexico	0	94	34,275	15,999
French West Indies	1,356	1,378	7,965	0
Brazil	0	0	15,944	0
Netherlands Antilles	0	0	2,637	0
Total Latin America	12,454	20,896	131,333	59,640
Netherlands	52,873	125,528	70,085	53,050
U.K.	10	1	0	4
Austria	8	16	8	2
W. Germany	5	6,449	139	29,384
Ireland	0	17,290	0	0
Norway	0	2,760	8,710	9,596
Finland	0	0	918	0
Belgium/Luxembourg	0	0	507	7,837
Italy	0	0	0	18,634
Total West Europe	52,896	152,044	80,367	118,507
Qatar	19,567	0	31,980	0
Libya	0	0	0	1,415
Israel	0	0	21	0
Total Mideast	19,567	0	32,001	1,415
Total Far East/Oceania*	0	0	9,582	9,964
Romania	7,333	0	62,603	162,478
East Germany	0	5,578	0	28,142
Total East Europe	7,333	5,578	62,603	190,620
Soviet Union	0	44,606	178,011	185,103
Japan	0	0	391	98
TOTAL WORLD	392,483	509,221	846,434	924,077

Note: Source is ACG, W.R. Grace & Co., Charts at 1-14-85, using U.S. Department of Commerce data for calendar years.

* All supplies are from New Zealand, except 1 ton from Hong Kong in 1984.

QUESTIONS AND ANSWERS ABOUT AMMONIA

Prepared by The Petrochemical Trade Group

June 26, 1985

Q. Why is ammonia so important?

A. Ammonia, which is produced by combining natural gas with air, is 82 percent nitrogen. It is the main source of nitrogen fertilizers, the lifeblood of modern agricultural methods used by U.S. farmers. Three-fourths of all ammonia used in the United States is used as fertilizer.

Q. Where do the subsidized imports come from?

A. Subsidized ammonia imports come primarily from the Soviet Union and Mexico. In addition, subsidized imports of urea (a solid nitrogen fertilizer made from ammonia, containing 46 percent nitrogen) are coming from the Soviet Union, Mexico, Romania and East Germany.

Q. What is the major cost in producing ammonia?

A. About three-fourths of the cost of producing ammonia is the cost of the natural gas feedstock. Using modern technology, about 36,000 cubic feet of natural gas is required to produce one ton of ammonia.

Q. How do the Soviets and Mexico subsidize their ammonia imports to the U.S.?

A. These governments subsidize exports by artificially lowering the cost of natural gas to their state-owned ammonia plants. They use an energy pricing scheme known as two-tier pricing. They provide natural gas to their own producers at a very low, government-set price that bears no relation to its market value. At the same time, they export natural gas to other users at the much higher commodity values determined by world markets. This scheme benefits their energy-intensive industries when they export energy-intensive products, like ammonia, into world markets.

Q. What do producers pay for natural gas in the Soviet Union?

A. The Soviet Union is not a market economy. Prices are administered by a central authority and it is difficult for Western analysts to get exact prices. However, analysts have estimated all costs of production and transportation of ammonia from the Soviet Union to the U.S. market, using Free World plants as models for comparison. Using such comparison, the analysts have concluded that Soviet producers pay virtually nothing for natural gas.

Q. How much do Mexican producers pay?

A. In Mexico, all energy resources are owned the government, and produced and marketed by Petroleos Mexicanos (PEMEX), the state energy monopoly. PEMEX is also the monopoly producer of ammonia and other commodity petrochemicals, and the sole exporter by law. In Mexico, there is no actual sale of natural gas to make ammonia. Gas is simply transfered to plants in the PEMEX monopoly chain. It is not clear what PEMEX charges itself for natural gas. In a countervailing duty case brought against Mexican ammonia in 1982, the Commerce Department applied an internal transfer price to PEMEX equal to PEMEX's industrial use rate on natural gas to other Mexican industries. PEMEX currently sells gas to other industrial users in Mexico for the equivalent of $1.62 per mcf. This is a delivered price anywhere in Mexico. However, Mexico will not export natural gas to the United States for less than $4.40 per mcf. As a result, all natural gas exports to the United States have ceased because U.S. gas prices are much lower.

Q. What do U.S. producers pay for natural gas?

A. U.S. ammonia producers now pay an average price of $3.12 per mcf. This average price reflects the fact that some U.S. producers still receive natural gas at low prices negotiated outside of U.S. government regulations back in the 1960's. Most of these contracts have already expired, and most of those remaining will expire this year and in 1986. The great majority of U.S. producers pay about $3.50 per mcf. This is the fair market value of gas in the U.S., the price a willing buyer would pay a willing seller without government intervention.

Q. Don't Mexico and the Soviet Union have a "comparative advantage" and cheaper gas because they have so much of it?

A. Both countries have large supplies of natural gas. So does the United States. But do not confuse government two-tier price manipulation with comparative advantage. A comparative advantage in gas does not automatically translate into a comparative advantage to produce ammonia and export it to the U.S. Soviet gas is not cheap to produce, at least by Western standards. Soviet ammonia is not cheap to produce either, and must be transported 7,000 miles to reach the U.S. Gulf Coast ports. Mexico can produce natural gas inexpensively, but is disadvantaged in capital construction costs, labor costs and transportation costs to produce ammonia and export it to the U.S. marketplace.

Comparative advantage in natural resource supply means that a country can sell its resource cheaper, but it should also mean that they should be willing to sell to any buyer at the same price.

Q. Do the Mexicans and Soviets sell gas to any buyer at the same price?

A. No. That is the problem. They specifically discriminate and manipulate the price of gas to give themselves an unfair advantage in the ammonia marketplace. They sell to themselves at below-market prices and to others at market prices. This practice helps to keep prices higher in other markets and retains their advantage to produce petrochemicals like ammonia. They can then export and undercut other producer prices to gain market share. This is not the exercise of comparative advantage.

Q. Are the Mexicans and Soviets using more modern technology to bring down their costs?

A. No. U.S. ammonia producers are among the most efficient in the world. U.S. producers use less natural gas than Mexican or Soviet producers. Most of the technology used in those countries was countertraded or bought from Western companies, including U.S. companies.

Q. Won't this legislation raise the price of nitrogen to U.S. farmers?

A. It would only raise prices to the extent that they reflect sales of subsidized ammonia below the real cost of production under the fair market value test. If the subsidies are eliminated or offset, there will be adequate domestic production and fairly-traded imports to meet demand and demand growth in the future. This will provide assured supplies of nitrogen fertilizer at competitive prices. No one can expect private producers to stay in the business or expand to meet demand if they are consistently forced to sell their product below their fully-allocated costs or even below variable costs. If efficient and competitive U.S. producers are driven from the market by unfair trade practices of foreign governments, there will be less competition, tight supplies and higher prices than there would have been with fair trade.

It must be realized that Mexican and Soviet energy pricing policies which subsidize their exports do not provide any long-term real benefit to U.S. farmers. Any price increases resulting from action against unfairly subsidized imports would not work to the detriment of farmers. What will really hurt U.S. farmers is the loss of U.S. fertilizer manufacturing capacity and excessive dependence on Mexican, Soviet, and Eastern Bloc producers. We have seen in the oil market how illusory and short-range were the benefits of "cheap" imports.

Consider that Mexican and Soviet ammonia were entering the U.S. market at about $120 per ton in 1983, when the PIK program reduced overall demand for nitrogen and U.S. producers were cutting back and shutting down. As soon as PIK ended and farm nitrogen demand rose again, the subsidized producers raised their prices to $180 per ton -- a 50 percent increase. This kind of pricing disruption would not result if market based producers were competing. Right now there are no cheap subsidized imports for U.S. farmers. The only reason that the subsidized producers would drop their prices again would be if their government planners decided to increase production and exports.

Q. Will this legislation cause retaliation against U.S. grain sales abroad?

A. History demonstrates that the United States is the world's residual grain supplier. Restoring competition to the U.S. ammonia fertilizer market will not change that fact. Over the last five years, U.S. exports of coarse grains and wheat have fluctuated between 94 and 111 million tons. The combined exports of all other nations have fluctuated between 72 and 87 million tons. Whereas other naticn's exports largely deplete their grain inventories, U.S. inventories remain substantial.

Q. But aren't we vulnerable on this point?

A. It is estimated that the maximum net U.S. vulnerability to grain trade reprisals is around 6 or 7 million tons. But over a short time -- basically one growing season -- our vulnerability would approach zero as foreign grain inventories were depleted. If one country shifted to another supplier rather than buying U.S. grain, alternative markets for our exports would open quickly.

Q. What about retaliation in general? Will this legislation result in further deterioration of our trade relationships?

A. In spite of arguments or fears, this legislation is consistent with the General Agreement on Tariffs and Trade. In fact, H.R. 2451 goes beyond our GATT obligations by extending the injury test to all countries, not just those that are Subsidies Code signatories or are otherwise entitled. The resource subsidy provision is a reasonable effort to deal with a clear and compelling economic distortion of the U.S. marketplace. For those reasons, the legislation is no different than any other major trade legislation passed by the Congress, including the 1984 Trade Act, the 1979 Trade Agreements Act and the 1974 Trade Act. All of these bills contained provisions that were unpopular in other countries and produced, at the time, much talk of retaliation -- but we do not know of any retaliatory action that came from the enactment of these measures. In fact, retaliation is only a threat that has no historical precedents when legislative initiatives are consistent with GATT and the general thrust of U.S. trade law.

Q. Why is this trade unfair?

A. Under the legislation, the cost components of imported products, such as ammonia, that are sold in the United States and cause injury, will be measured against a fair value standard. That standard is based on a variety of factors that the Department will utilize to determine what the component price would be in a free market setting. If, because of government action, a producer in an exporting country pays less than that fair market value, then there is a subsidy that is no different in purpose or effect than the other domestic subsidies already countervailed under the U.S. law. The theory is simple. If a government directly or indirectly provides a product to a producer at less than its fair value and that producer uses the input in making a product that is then sold in a third country, then remedial action is justified to ensure that markets in the importing country are not distorted. The resource input subsidy is comparable to countervailable subsidies, such as providing government loans to producers at rates that are below what a commercial banker would charge, or government purchase of stock in a company at a price per share that is more than the local stock market price. In all of these cases, the trade is unfair because through the artificial intervention of a government, the exporting producer pays less for essential funds or inputs than would be paid if the marketplace were relied on to set prices.

Q. If Mexico is willing to sell gas at about $1.62 per mcf, why don't U.S. producers buy their gas from Mexico?

A. This is the crux of the problem. As we said, Mexico has a two-tier pricing system. PEMEX sells only to Mexico's industry at that price. For U.S. buyers, it is either $4.40 per mcf or it is no sale. Right now, it's no sale.

Q. Why don't U.S. producers go down to Mexico and set up operations?

A. It is not an option. Production of commodity petrochemicals like ammonia are the sole province of PEMEX. PEMEX is the monopoly producer and no other producers are allowed into the market. In addition, Mexico puts a tariff on ammonia imports of 60 percent ad valorem.

Q. How do other countries handle the sale of natural gas to ammonia producers?

A. In Trinidad, the government negotiates specific contracts with each plant or company producing ammonia. Gas prices reflect competitive ammonia prices. Gas contracts are generally long-term contracts negotiated at the time the plant was built and reflect the estimated life of the plant. This was to induce the initial investment. In effect, gas prices are negotiated at arm's length, and all marketing of the ammonia or urea is handled by the private producer, even where the government retains an ownership interest in the plant.

It is our understanding that Petromin in Saudi Arabia sells gas to petrochemical producers and refineries for about 50¢ per mcf. We do not know if each contract is negotiated separately or whether the government sets a single price for the gas. It is our further understanding that most of the associated gas in Saudi Arabia at current crude oil production levels has been committed to existing petrochemical plants, refineries and other industrial facilities that are completed or under construction. If this is the case, then further gas sales are contingent upon increased oil production or separate drilling and production for natural gas.

Saudi Arabia and Trinidad are similar in that they do not have access by pipeline to sell natural gas directly in export markets. Mexico, Canada and the Soviet Union, by contrast, do have such access to major natural gas markets in the United States and Europe. The limitations on transportability and market access in Saudi Arabia and Trinidad can be expected to produce different market values for gas. In most instances, these values will be lower than the values of Mexican, Canadian or Soviet gas. These conditions may change in the future.

Q. How do the subsidized imports affect U.S. market prices?

A. Ammonia is sold in a commodity type market. In such markets, the lowest price increment sets the price for the market. It doesn't take a lot of subsidized imports to drive down market prices. There is no way to determine what percentage of the market actually needs to be taken by such imports before they disrupt the pricing structure -- but it is very small.

There is the additional consideration that government subsidized producers, unlike private producers, do not need to attempt to match production with demand. Even during periods of demand decline, government subsidized producers may continue to produce at maximum rates and export into oversupplied markets, further depressing prices.

Q. Hasn't the U.S. had price controls on natural gas that subsidize industry?

A. Until the late 1970's, U.S. natural gas prices (at least in interstate markets) were probably held below what they would have been without government regulation. In 1978, the Natural Gas Policy Act (NGPA) began moving U.S. natural gas prices from production-cost basis to a commodity value basis. The price of gas first rose toward what a buyer would be willing to pay. Since 1981, prices dropped to reflect market conditions. In today's market, U.S. industry pays such market clearing prices -- fair market value -- for natural gas.

Over half of all U.S. natural gas was fully decontrolled on January 1, 1985. But for several years prior to that, U.S. industry had effectively paid market clearing prices for gas. The price of natural gas had fallen below NGPA allowable ceilings as market forces exerted pricing dominance. It appears to be an anomoly that fairly traded ammonia imports will help keep prices of gas competitive to U.S. producers. Industrial gas users pay a large share of the fixed cost of gas pipeline and distribution companies, thus keeping costs down for commercial and residential customers. Pipelines and distribution companies have an incentive to buy and sell gas at prices that increase the volume of sales and spread their fixed costs over a larger base. Subsidized ammonia imports, however, will shut down U.S. ammonia producers who are then lost as gas customers, increasing costs to remaining gas customers.

Q. What is your estimate on the amount of the subsidy on Mexican ammonia imports based on conditions today under the proposed legislation?

A. PEMEX currently sells gas at an industrial use rate equivalent to $1.62 per mcf. Gas is sold at this rate at any location in Mexico. The Department of Commerce would have to deduct comparable transportation costs or average system costs to determine the wellhead price in Mexico. We estimate the wellhead price to be approximately $1.00. Mexico clearly has the alternative of selling gas to the United States. The wellhead price of gas in Texas or Louisiana would be the competitive price at which Mexico could sell gas at the United States border. That price is around $2.50 per mcf. today. The subsidy would therefore be about $1.50 per mcf. PEMEX uses approximately 38 mcf. per short ton of ammonia compared to under 36 mcf. per short ton in the United States, thus the PEMEX subsidy would be approximately $57 per ton. The subsidy might be slightly less depending on the U.S. wellhead price and Mexican transportation costs determined by the Department of Commerce in a particular case. It is useful to note that the Canadian gas export price has dropped recently under the new U.S. border pricing rules to a range of between $3 - $3.50 per mcf.

Q. In the past, opponents to this legislation argued that there was no injury to U.S. ammonia producers because the volume of ammonia imports from Mexico or the Soviet Union was too small in relation to the U.S. market. H.R. 2451 provides for an injury test in all cases under resource input subsidies. Is across-the-board application of the injury test reasonable and good policy?

A. Their is no objection to the application of the injury test per se. Our objection was first in the way cause of injury was being determined by the ITC in cases involving commodities. Secondly, we objected to giving Mexico the injury test in a bilateral agreement that did not require Mexico to change its two-tier energy pricing policy in ways to eliminate the subsidization of its ammonia and other commodity petrochemical exports to the United States.

The ITC currently determines whether imports cause injury by a rule that requires market penetration of at least 2.5 to 5.0 percent. In commodity markets, even smaller volumes of subsidized imports can undercut or depress prices. Since the incremental unit sets the price at any given time in a commodity market, subsidized imports can always be priced to penetrate the market. The lowest price quickly becomes the maximum price buyers are willing to pay. U.S. producers must match those prices or lose sales. The result is lost profits or lost sales. When prices are depressed below U.S. producers' fully allocated costs or even variable costs of production for extended periods, they are forced to shut down their plants.

On occasion, the ITC has tried to find the price leader that undercuts prices. In commodity markets, that is, for all intents and purposes, a futile search. Looking back over several months, it is impossible to determine whether an importer, broker, producer or other trader or reseller was the first to cut prices in commodity markets. There are simply too many sales on different terms and conditions. Prices are negotiated with individual buyers and reported in the trade press. Price ranges do become very narrow when there are a lot of sales. But you can seldom determine who set the lowest price or offer first.

If prices are being depressed and subsidized imports are being sold at those prices, then the ITC should not hesitate to find the necessary causual relationship between the unfair act and injury to the domestic industry.

On the question of trade policy, it does not appear in the interests of the United States to enter into bilateral arrangements, unless the subsidizing countries are willing to eliminate their subsidy practices. Likewise, H.R. 2451 goes beyond GATT requirements in applying the injury test in all cases of resource input subsidies. Most energy-producing countries that would be most subject to this amendment are not members of GATT nor have they signed the Subsidies Code. Granting the injury test across-the-board reduces any leverage on them to do so.

APPENDIX A

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June 21, 1985

The Honorable Sam Gibbons
Chairman
Subcommittee on International Trade
Committee on Ways and Means
United States House of Representatives
Longworth House Office Building
Independence Ave. between C St. and
South Capitol St., N.E.
Room 1102
Washington, D.C. 20515

Dear Mr. Chairman:

I am advised that a spokesman for the Executive Branch recently testified before the Subcommittee on International Trade of the Committee on Ways and Means in opposition to the natural resource subsidy provision contained in H.R. 2451.[1] Reportedly, it is the position of this official that the natural resource subsidy provision would constitute a "violation" of the General Agreement on Tariffs and Trade (GATT) and the interpretative Arrangement on Subsidies and Countervailing Measures (the MTN Subsidies Code).

This letter is offered as a rebuttal to the position adopted by the Executive Branch. I am writing in several capacities: as a former general counsel of the Office of the Special Trade Representative (1979-1980); as the former head of the U.S. negotiating team which was responsible for the negotiation of the MTN Subsidies Code; and as a private practitioner who presently serves as the counsel to the Ad Hoc Committee of Nitrogen Producers and to the Independent Refiners Coalition.

In my opinion the position adapted by the Executive Branch (i.e. that the natural resource subsidy provision would constitute a "violation" of the GATT and the MTN Subsidies Code) is unjustified as a matter of either law or fact. In truth, there is nothing in either the GATT or the MTN Subsidies Code that precludes the United States from recognizing that natural resource pricing practices may constitute countervailable subsidies. Furthermore, there is nothing in either the GATT or the Subsidies Code which would prohibit the U.S. Government from countervailing these practices and using any reasonable basis for measuring the level of that subsidization.

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[1] Testimony of Ambassador Michael B. Smith, Deputy U.S. Trade Representative, before the Subcommittee on International Trade of the Committee of Ways and Means, Washington, D.C., June 6, 1985.

As you are well aware, the natural resource subsidy provision contained in H.R. 2451 is designed to address the trade problem created by two tier natural resource pricing, a problem exemplified most dramatically in the case of Mexican amonia production. Under that scheme, the Government of Mexico provides natural gas to domestic users, including amonia producers, at a price which bears no relationship to its true value. It provides an incentive to exports, prohibits imports and creates trade distortions. The Department of Commerce has taken a position that this practice does not constitute a countervailable subsidy on grounds that the natural gas is "generally available."

In my opinion, there is no basis in the GATT, in the MTN Subsidies Code; in the negotiating history of the Code, or in the legislative history of the Trade Agreements Act of 1979 for the overly restrictive position the Department has adopted with respect to the "general availability" or "specificity" test. The Department, itself, invented the phrase.

In the negotiation of the MTN Subsidies Code the United States sought an improved international discipline on subsidies or, in the alternative, an international system which allowed the United States to use its countervailing duty statute to offset subsidy practices which cause material injury to U.S. producers. Prior to 1979, U.S. law did not require a demonstration of material injury to domestic producers by reason of imports before countervailing duties could be imposed. This was a source of considerable friction and heat in our trading relationships. In addition, there was no international recognition prior to 1979 that subsidies other than export subsidies (e.g. domestic subsidies) could be countervailed. For these two reasons, the United States had been very reluctant to use its countervailing duty statute to offset foreign domestic subsidy practices under the law. In the negotiation of the MTN Subsidies Code, the United States agreed to amend its countervailing duty statute to require proof of material injury prior to the imposition of countervailing duties. This concession was made in return for, among other things, the provisions in the Code relating to domestic subsidies, making it clear that such practices may be countervailed if they cause material injury. This trade-off did not limit the countervailability of domestic subsidies by a specificity or generally available test. It noted that "normally" such subsidies are applied regionally or to sectors of industry. But some of the examples included domestic subsidies that would be generally available under the current position of the Department. This was the great trade-off in the MTN Subsidies Code negotiation.

Neither the GATT nor the Subsidies Code define what is meant by the term "subsidy." During the Subsidies Code negotiations no one contemplated that government programs such as fire and police protection would be countervailable. However, at the time no one contemplated that the Department of Commerce would rule, for example, that certain Brazilian concessional loan programs are not countervailable because they are "generally available" to borrowers.

In my opinion, the Department of Commerce is contriving a doctrine in order to limit greatly the class of foreign government subsidy programs which it will countervail. The Department is doing this, presumably, because it makes the countervailing duty statute more administrable and less a point of friction with foreign governments.

There was no intention on the part of the U.S. negotiators or the Congress in 1979 to limit so severely the class of domestic subsidies which are countervailable if they cause material injury. For the Department to be adopting this position now is contrary to the intent of the Code and the Congress. Moreover, for the Department to undertake to base that position on a convoluted and specious interpretation of the GATT is disingenuous, to say the least.

An anecdote from the Subsidy Code negotiations might be helpful at this time. In the mid 1970's the European community was faced with growing competition from U.S. synthetic fiber and other petrochemical exports. The Community complained that these exports were subsidized by virtue of U.S. natural gas price controls and threatened to countervail against such practices. We were acutely sensitive to this problem during the negotiation of the Subsidies Code, but at no time did we undertake to argue that such a practice did not constitute a countervailable subsidy because it was "generally available."

More recently, the French Government has complained to the Commission of the European Communities with respect to a Dutch Government two tier pricing policy for natural gas. This policy had the result of subsidizing Dutch fertilizers (Dutch used it to outbid French and others on export sales). The Commission has ruled that such a practice constitutes an illegal subvention.

I am the first to admit that the problem posed by two tier pricing is a especially vexing one. However, the position of the Executive Branch is a disappointment to say the least. To fall back on that old canard that "it will violate the GATT" serves no purpose whatsoever but to delay substantive action on this important issue.

Sincerely,

Richard R Rivers

Richard R. Rivers, P.C.

RRR:kjm

APPENDIX B

WILEY & REIN

MEMORANDUM

TO: Ad Hoc Nitrogen Committee

FROM: Charles Owen Verrill, Jr., and Robert C. Weissler

DATE: June 12, 1985

RE: **HR 2451 Would Not Violate the GATT Obligations of the United States**

During testimony before the Subcommittee on Trade of the House Ways and Means Committee on June 6, 1985, Deputy United States Trade Representative Michael B. Smith expressed the Administration's opposition to HR 2451, arguing that in "its present form the bill violates the GATT." (Testimony at 3.) From this assertion, Ambassador Smith posits the usual consequences of GATT inconsistent action as reasons for the Administration's "concerns" with HR 2451. We believe, however, that Ambassador Smith has misread GATT Article VI (which provides for countervailing duties) and the Subsidies Code and that HR 2451 would not offend either the letter or spirit of those obligations.

A. The Subsidies Code Does Not Define Domestic Subsidies By a Specificity Benchmark

Ambassador Smith and others[*/] have argued that GATT Article VI and the Subsidies Code require Congress to mark "the dividing line between permissible and impermissible government subsidies" by reference to the "generally available" test. (Testimony at 5-6.) And, he argues, the Code reflects an "international consensus" on those subsidies that "are properly the subject of countervailing duties...." This argument is premised on Code Article 11:3[**/] which Ambassador Smith--like other proponents of the specificity test--quotes to demonstrate a "universal international acceptance" [***/] of the notion (mistaken in our opinion) that the only properly actionable subsidies are those granted "regionally or by sector." (Testimony at 5-6.) Objective analysis of the Code, however, conclusively demonstrates that

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[*/] See, for example, Judith Bello and Alan Holmer, Subsidies and Natural Resources: Congress Rejects a Lateral Attack on the Specificity Test, 18 Geo. Wash. J. Int'l. L. & Econ. 297, 305 (1984), where the authors argue that the Subsidies Code mandates a limit on countervailable domestic subsidies to those provided "to specific regions or sectors, not those made more widely available."

[**/] The relevant Code provisions are reproduced in Annex A.

[***/] Since the Code has only been ratified by a small fraction of the countries in the world, it is obviously not "universally" accepted.

it does not in any way limit the authority of Congress to define as countervailable subsidies the domestic programs of foreign governments that increase exports to the United States and injure U.S. industries.

In the first place, the Code does not define countervailable domestic subsidies. Instead, the Code acknowledges that domestic subsidies are used by governments to achieve national objectives including, among others, "generally to sustain employment and to encourage re-training and change in employment," "to encourage research and development," "to promote the economic and social development of developing countries," and "to avoid congestion and environmental problems." (Art. 11:1) These objectives would obviously involve, and the Code so acknowledges, broad-based subsidies not necessarily limited to any particular sector or group of enterprises or regions.*/

Having acknowledged the perogative of governments to adopt domestic subsidy programs, the Code (without reference to regions or sectors) establishes the obligation of signatories to avoid causing (or threatening) injury to a domestic industry in another country through the use of such subsidies. (Article 11:2) This obligation, we emphasize, applies to all domestic programs without any qualification based on availability. Further, in discussing the requirements for countervailability, the Code nowhere mentions any such qualification. (See Articles 2, 4.) This demonstrates, therefore, that the Code--instead of reflecting a specificity requirement--in fact explicitly rejects any such limitation. Otherwise, the obligation to avoid extraterritorial injury would be meaningless with respect to programs that are "generally available."

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*/ The Subsidies Code recognizes that such objectives may involve broad-based programs, stating that these objectives "may be achieved, inter alia, by means of subsidies granted with the aim of giving an advantage to certain enterprises." (Article 11:3.)

As a consequence of the Code obligations, the United States is obligated to avoid domestic subsidies that may cause injury to other trading nations and has the right--without being limited by notions of specificity--to define domestic subsidies, for purposes of the U.S. countervailing duty law, as those foreign practices that injure domestic industries and which the granting government has an obligation--under the Code--to avoid. International trade effects, therefore, are the litmus of a Code acceptable countervailing duty law--not the defined class of subsidy recipients.

The Code does provide "[e]xamples of possible forms" of domestic subsidies, such as "government financing of commercial enterprises, including grants, loans or guarantees; government provision or government financed provision of utility, supply distribution and other operational or support services or facilities; government financing of research and development programmes; fiscal incentives; and government subscription to, or provision of, equity capital." (Article 11:3.) And, the Code states that these forms of subsidies "are normally granted either regionally or by sector." (Emphasis added.) But the Code has no prohibition on countervailing subsidies that are not regional or sectoral and emphasizes that the list is "illustrative and non-exhaustive." No objective reading of the Code can elevate these "non-exhaustive" illustrations of possible "forms of subsidy" into an obligation that limits Congress in the definition of a countervailable subsidy. */

In fact, the Code recognizes that the illustrative list of domestic subsidy practices should be "reviewed periodically." (Article 11:3.) This is entirely consistent with the authority of Congress to revise the U.S. law to take account of the dynamics of world trade and evolving subsidy programs in other countries. The Code's description of possible forms of domestic subsidies that were apparent in 1979 and the observation that those "forms" are "normally

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*/ Bello and Holmer base their case for a specificity requirement on the illustrative list by transforming "examples of possible forms" of subsidy into a substantive requirement which they are clearly not. See 18 Geo. Wash. J. Int'l. L. & Econ. at 304-05 & n.45.

granted either regionally or by sector" does not set limits on the authority of Congress to evolve concepts of countervailable subsidies. Instead, the only Code mandated limitation is that newly minted domestic subsidies can only be countervailed if they have adverse extraterritorial effects on industries in other countries.

In summary, the Code does not "mandate" a specificity requirement. Instead, the Code describes "possible" forms of subsidy that were generally in use in 1979, but categorically states that the illustrations are non-exhaustive. Therefore, Congress and the legislatures of other signatories have authority, that is not limited by any specificity benchmark, to define countervailable subsidies to take into account domestic programs in other countries that cause extraterritorial injury.

B. Enactment of HR 2451 Would Not Open a Pandora's Box

Another argument is that the "generally available" test provides a "safe harbor" where exports of U.S. industries are secure from countervailing duties. Absent this test--so the argument goes--other countries would have an "open season" on U.S. exports that benefit from a wide variety of federal programs that are designed to foster economic growth (citing tax breaks, defense and scientific research, etc.). This, of course, is a practical consideration--not a GATT or Code argument--that counsels caution in devising new definitions but does not forever "freeze" the examples of subsidy in the Code as the limits of countervailing duty law.

The natural resources bill now before the Subcommittee would not open a Pandora's box because it is not an attack on general government intervention (such as public schools) but rather a carefully crafted effort to address a form of offshore domestic subsidy that is not available to U.S. producers but which has injurious effects in the U.S. markets. This is the type of subsidy that has the potential for injurious effects on world trade because only a limited class (producers in the resource country) have access to the subsidy benefit.

Neither the Code nor the 1979 Trade Agreements Act forecloses Congress from addressing such forms of subsidy. The possibility that our trading partners may do likewise is entirely consistent with Code Article 11:3 which makes very clear that "[t]he enumeration of forms of subsidies set out above is illustrative and non-exhaustive, and reflects those currently granted by a number of signatories to this Agreement." And, the Code clearly contemplates that the U.S. Congress and other signatories will revise their laws--within Code principles--to reflect changing conditions.

C. HR 2451 Does Not Penalize Comparative Advantage

Nobody disputes the fact that comparative advantage is a tenant of world trade. Ambassador Smith is wrong, however, in his claim that HR 2541 would "strike at the heart of comparative advantage," since the resource subsidy definition would only apply where U.S. producers are denied equivalent opportunity to exploit such advantage.[*/] In other words, only those countries that deny national treatment in their allocation or distribution of resources would be potentially subject to application of HR 2451.

CONCLUSION

Congress obviously has authority to amend the countervailing duty law to address an international trade problem that Ambassador Smith has acknowledged. Such amendments should adhere to the Code's procedural requirements and mirror the domestic subsidy obligations. These obligations do not include a delimiting specificity requirement. Instead, where a domestic program in a foreign country violates the obligation to avoid adverse effects in the United States (or any other signatory), then Congress is

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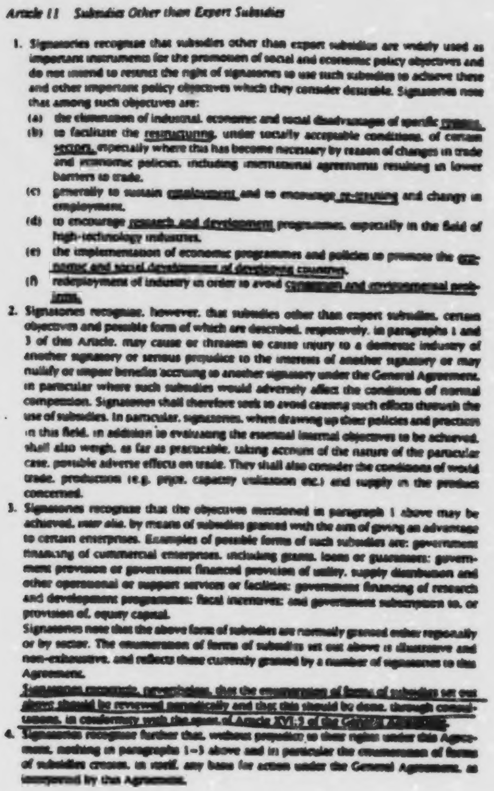
[*/] Indeed, inducing vertical integration of natural resource production and manufacture may well distort comparative advantage if the facilities are excessive to world needs and/or justifiable only because of the natural resource distortion.

entitled to amend the law to provide a countervailing remedy. Such evolution of countervailable subsidy concepts is, in fact, anticipated by the Code which emphasizes that the description of subsidies available in 1979 was illustrative and, more important, non-exhaustive.

ANNEX A



Article 11 Subsidies Other than Export Subsidies

1. Signatories recognize that subsidies other than export subsidies are widely used as important instruments for the promotion of social and economic policy objectives and do not intend to restrict the right of signatories to use such subsidies to achieve these and other important policy objectives which they consider desirable. Signatories note that among such objectives are:
   (a) the elimination of industrial, economic and social disadvantages of specific regions,
   (b) to facilitate the restructuring, under socially acceptable conditions, of certain sectors, especially where this has become necessary by reason of changes in trade and economic policies, including international agreements resulting in lower barriers to trade,
   (c) generally to sustain employment and to encourage re-training and change in employment,
   (d) to encourage research and development programmes, especially in the field of high-technology industries,
   (e) the implementation of economic programmes and policies to promote the economic and social development of developing countries,
   (f) redeployment of industry in order to avoid congestion and environmental problems.
2. Signatories recognize, however, that subsidies other than export subsidies, certain objectives and possible form of which are described, respectively, in paragraphs 1 and 3 of this Article, may cause or threaten to cause injury to a domestic industry of another signatory or serious prejudice to the interests of another signatory or may nullify or impair benefits accruing to another signatory under the General Agreement, in particular where such subsidies would adversely affect the conditions of normal competition. Signatories shall therefore seek to avoid causing such effects through the use of subsidies. In particular, signatories, when drawing up their policies and practices in this field, in addition to evaluating the essential internal objectives to be achieved, shall also weigh, as far as practicable, taking account of the nature of the particular case, possible adverse effects on trade. They shall also consider the conditions of world trade, production (e.g. price, capacity utilization etc.) and supply in the product concerned.
3. Signatories recognize that the objectives mentioned in paragraph 1 above may be achieved, inter alia, by means of subsidies granted with the aim of giving an advantage to certain enterprises. Examples of possible forms of such subsidies are: government financing of commercial enterprises, including grants, loans or guarantees; government provision or government financed provision of utility, supply distribution and other operational or support services or facilities; government financing of research and development programmes; fiscal incentives; and government subscription to, or provision of, equity capital.
   Signatories note that the above form of subsidies are normally granted either regionally or by sector. The enumeration of forms of subsidies set out above is illustrative and non-exhaustive, and reflects these currently granted by a number of signatories to this Agreement.
   Signatories recognize, nevertheless, that the enumeration of forms of subsidies set out above should be reviewed periodically and that this should be done, through consultations, in conformity with the spirit of Article XVI:5 of the General Agreement.
4. Signatories recognize further that, without prejudice to their rights under this Agreement, nothing in paragraphs 1–3 above and in particular the enumeration of forms of subsidies creates, in itself, any basis for action under the General Agreement, as interpreted by this Agreement.

APPENDIX C

GRACE

Kenneth Y. Millian, Vice President
Corporate Administration Group

W. R. Grace & Co.
1511 K Street, N.W.
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(202) 628-6424

May 29, 1984

Mr. Olin L. Wethington
Deputy Under Secretary
for International Trade
U.S. Department of Commerce
Washington, D. C. 20230

Re: Natural Resource Subsidy Provision of H.R. 4784

Dear Mr. Wethington:

I am responding to your request for further information from me following our discussion on May 23 regarding the Natural Resource Subsidy provision of H.R. 4784. At that time, you stated the Administration's major objection to the Natural Resource Subsidy provision was that "our national gas price regulations make us vulnerable" to mirror legislation. This objection appears to have originated from complaints by some European governments in the late 1970's that U.S. petrochemical and textile exports were benefiting from regulated U.S. natural gas prices that were "lower than world prices." You will recall I indicated that this objection is no longer valid. This letter and the enclosed analysis describes why the Department's objection is not valid and why we believe that objection is based on an incorrect reading of the current situation.

First, we are not vulnerable to mirror legislation because it is clear that gas prices to U.S. petrochemical producers are now at market clearing prices, which represent "fair market value" under H.R. 4784. By virtually any measure -- average wellhead prices, purchases by pipelines, or comparisons to decontrolled alternative fuel prices paid by industrial users in the United States -- current U.S. natural gas prices to most industrial users are below NGPA ceiling prices and are negotiated between buyers and sellers in a competitive market. If NGPA were setting prices below fair market value, then virtually all gas would be selling at the maximum ceilings. That would again induce additional drilling and additional supplies, and prices would drop below ceilings again.

Second, the provision applies only when the price of a natural resource like gas is specifically manipulated by a government to be lower than the export price or the fair market value of the resource. Fair market value is defined as the price a willing buyer would pay a willing seller in an arm's length transaction absent government intervention. As in the United States, fair market value pricing can exist within a framework of government regulation. The mere existence of a regulatory pricing system is not sufficient to constitute a subsidy under the Natural Resource Subsidy provision. Such regulation is not actionable so long as it does not function to artificially lower prices below fair market value.

Third, even assuming additional categories of U.S. gas are deregulated on January 1, 1985, prices to industrial users are unlikely to rise because current prices negotiated on new contracts already reflect market conditions. Increases and decreases in price will continue to be primarily determined by market forces. Since current average wellhead prices are dropping, if anything, NGPA may be acting to hold average prices to industrial users above market clearing levels.

We point out that any challenge to NGPA, claiming it bestows a subsidy on U.S. producers, must take into account the myriad of prices at which gas is bought and sold in the U.S. marketplace by private producers, private distributors and private users. By contrast, in Mexico, PEMEX is the state monopoly producer of energy resources and basic petrochemicals, including all fertilizers. The government sets a single delivered price to all domestic industrial users. In Mexico, no myriad of private users competes for supply and price. PEMEX itself and the state-owned electric utilities are by far the major industrial gas users.

In addition, foreign producers and investors are denied any effective commercial access to the lower gas prices through export or through investment in petrochemical plants. The U.S. does not discriminate against market access by foreign investors in this fashion. Only with these artificial constraints can Mexico maintain its differential pricing practice. The marketplace, operating under the market principle of comparative advantage, could not set prices in this way or at such rigid and discriminatory differentials.

The Administration has repeatedly stated that under the internationally accepted definition of subsidy, a countervailable domestic subsidy is government action or direction that attempts to give one or more industries a special advantage over other industries in that economy. Two-tier energy pricing clearly gives an enormous advantage to a few energy-intensive industries over its nominal effect on other industries. In addition, the "accepted" definition requires that such a subsidy practice distort the allocation of resources within an economy. Clearly, two-tier energy pricing has distorted the allocation of resources within Mexico. It has encouraged the concentration of scarce capital in capital-intensive petrochemical plants, encouraging the excess production of energy-intensive products like anhydrous ammonia at prices which do not recognize the true economic value of the energy used. It also increases exports of energy-intensive products and prohibits imports in a way which could not exist without government intervention. The Mexican Industrial Development Plan specifically states:

> This plan [the IDP] is complemented by an explicit policy of maintaining internal prices of energy sources for industrial use

> below that of the international market. This allows for the strengthening of industry by giving it a substantial margin of protection via inputs. In contrast to other forms of protection which tend to make such costs more expensive and access to external markets more difficult, this mechanism constitutes a direct incentive to exports. (emphasis added)

In short, the effects of this pricing scheme meet virtually all of the international or U.S. standards for determining the existence of a countervailable subsidy.

Current U.S. countervailing duty law, as interpreted by the Commerce Department, however, adopts a single, simplistic mechanical test for actionable domestic subsidies. The Department concludes that a domestic subsidy bestowed on a specific industry or group of industries will distort the allocation of resources in all cases and is therefore countervailable. Conversely, a domestic subsidy made generally available, no matter how nominally, and regardless of its subsidizing effect on trade, will not distort the allocation of resources in any case and therefore is not countervailable. (See Secy. Baldrige and Amb. Brock letter to Chairman Rostenkowski, dated April 3, setting out Administration objections to H.R. 4784.)

Simple reason argues that such a mechanistic rule and a single test cannot be accurate in all cases to determine whether there is a distortion in the allocation of resources that affects imports and exports. There clearly could be a case of a domestic subsidy to a specific industry which does not result in the misallocation of resources or trade distortion. There also could be a case where a domestic subsidy made "generally available" is of such a nature that it does distort the allocation of resources and trade. For example, direct government intervention in the ownership, control and pricing of energy resources and downstream energy-intensive production through state monopolies, as contrasted to general tax policies, could produce such a result.

Even a cursory examination of the actual effect of two-tier energy pricing as practiced by the Mexican government demonstrates the distortive effect which is the hallmark of actionable subsidies even though it is "generally available" on a nominal basis. We do not believe that U.S. law or our international obligations under GATT require a blind allegiance to this single, exclusive mechanical test that flies both in the face of reason and the facts. It simply does not cover all countervailable domestic subsidies as defined under "internationally accepted" standards. The Natural Resource Subsidy provision is specifically limited to address only the particular case that has the required distortive effects, but which does not fall under the more general rule. It does not eliminate the general availability rule as some have alleged.

Regarding the past complaints of some European nations, U.S. gas prices are now comparable to producer prices in Europe. Some sale prices to industrial users may be distorted on the high side by individual state government taxes on energy (as in France) or by import contract prices, most notably those associated with the new Soviet gas pipeline. It would appear that based on the complaints in the 1970's, the Europeans believed that gas prices regulated below world market values would be a subsidy. The Natural Resource Subsidy provision's measure of subsidy is even more reasonable, since it is not based on a single world market price. It incorporates "fair market value," which accounts for regional and other market factors, as well as comparative advantage factors.

Under the Natural Resource Subsidy provision, price differentials from "prices generally available in world markets" would be taken into account wherever relevant. The Natural Resource Subsidy provision does not establish a single world gas price based on U.S. prices, any other country's prices, or the Btu equivalent price of oil as the standard for fair market value. The provision would account for regional differences in gas prices due to transportation limitations, and limits on accessibility to export markets on a commercial or competitive basis. The accessibility factor must be fully considered under any "fair market value" determination in a country which cannot export significant amounts of natural gas except by liquifying it. This is the case for many Middle Eastern countries and countries like Trinidad in our hemisphere. These are all normal factors that should operate in the marketplace to establish prices.

The "fair market value" test, which is the cornerstone of the Natural Resource Subsidy provision, is anchored in market-based pricing principles. It is fully consistent with this Administration's position to accelerate deregulation of natural gas; revision of the former single border price rule on gas imports by DOE on February 22, 1984, to shift to competitive pricing between buyers and sellers; and decontrol of oil prices.

In summary, the U.S. is not vulnerable to mirror legislation if the Natural Resource Subsidy provision of H.R. 4784 is passed into law. The provision attacks specific forms of subsidy practices associated with state ownership and pricing of natural resources such as energy, and where state ownership and control of the downstream production and pricing of energy-intensive products accounts for a significant level of the total use of the resource. If the United States continues to rely solely on the single, mechanistic general availability test to exclusively define countervailable domestic subsidies, the result will be ever more serious injury to the U.S. petrochemical industry and other energy-intensive products. The unfairness is that we are not losing out to more efficient producers with a comparative advantage in low cost gas. We are losing out to less efficient government producers, which use their monopoly power and price manipulation to capture markets they otherwise could not capture.

We appreciate the Department's general concerns about this legislation, but we believe our specific concerns are also legitimate and address a growing subsidy and market access problem. We further believe that since the Natural Resource Subsidy provision is limited to countervail only against domestic natural resource subsidies which fall well within the internationally accepted definitions of such subsidies, the United States would therefore not be subject to compensation claims under GATT. Because the amendment would be part of our CVD law, we are entitled to all of the GATT review and dispute resolution mechanisms available to GATT members before any such claims could be made, and we have every reason to believe such an amendment to our CVD laws is a proper exercise of authority under our international obligations. We would be pleased to work with you to resolve our differences and seek a mutually acceptable solution to this problem as this legislation progresses.

Sincerely,

Kenneth Y. Millian

Enclosure

5/25/84

APPENDIX D

DETERMINING THE MARKET WELLHEAD PRICE OF NATURAL GAS FOR INDUSTRIAL USERS UNDER H.R. 4784

Prepared on Behalf of Domestic Nitrogen Producers'
Ad Hoc Committee
by Margo Thorning, Ph.D.

Introduction

The purpose of this paper is to analyze the determinants of the wellhead price of natural gas paid by industrial users in the United States. This analysis supports the conclusion that market forces are the primary determinant of gas sales to U.S. industrial users. It has been suggested that current gas contract prices, rather than being determined by market forces, are being held down by the pricing provisions of the Natural Gas Policy Act (NGPA). This analysis indicates this is not the case. This distinction is important to the consideration of the Trade Remedies Reform Act of 1984, H.R. 4784.

The "Natural Resource Subsidy" provision of H.R. 4784 defines as a countervailable subsidy the practice of certain foreign governments in setting the domestic price of natural energy resources to industrial users, through government regulation or controls, below the export price or "fair market value" of those natural resources. This policy specifically benefits their energy-intensive industries by providing protection from imports and as an incentive to exports. It thus distorts the allocation of resources to favor such industries. H.R. 4784 would apply only to intensive users of a natural resource, like natural gas or fuel oil. Two-tier pricing of natural resources particularly applies to such pricing of natural gas or fuel oil used as feedstocks for production of petrochemicals or other products like cement.

Under H.R. 4784, the "fair market value" of gas in Mexico, for example, would be determined by the market clearing price or average price of gas to competing U.S. producers in the United States among other factors. It is basically a measure of the price at which Mexico could sell its gas in readily available markets at market prices as an alternative to sales at the subsidized level to industrial users in Mexico. The restrictions and limited scope of the Natural Resource Subsidy provision would also establish a different "fair market value" for natural gas from the Soviet Union or Saudi Arabia, since available competitive markets for export gas sales are in Europe or nonexistent in world markets, respectively.

In addition to showing that market forces primarily set current gas prices to industrial users in the United States under NGPA, alternative methods of determining the market clearing wellhead price of gas are presented.

1. What Determines The Price of Natural Gas?

There are two competing theories of what currently determines natural gas prices to industrial users in the United States. One theory holds that price ceilings incorporated in the Natural Gas Policy Act (NGPA) are keeping wellhead gas prices below the level which would obtain in the absence of regulation. An alternative theory is that gas prices are not being restrained by the price ceilings in the NGPA and that current gas prices represent conditions which would prevail in the absence of regulation.

A. Price Ceilings for Natural Gas

If the price ceilings mandated by the Natural Gas Policy Act of 1978 (NGPA) actually determine today's gas prices, then industrial users should be paying a price which reflects NGPA ceiling prices on new gas contracts. Although there are twenty-two different NGPA gas categories, pipelines are likely to be purchasing predominantly Section 102 or 103 gas because most of the gas currently available for sale falls into these two categories.[1] Therefore, the price charged for new contracts to industrial users should reflect the pipeline acquisition cost of Section 102 or Section 103 gas (Appendix A). As of March 1984, these ceiling prices were $3.63 and $2.87 per million Btu's respectively. Gas classified in lower NGPA price categories is generally not available because it is already committed under long-term contracts. There is gas available in higher price categories, such as Section 108 (stripper gas).[2]

If NGPA price controls are binding, that is, if they effectively hold the price of gas below the price that would obtain in the absence of regulation, then the wellhead price paid by users for current contracts would reflect a weighted average of NGPA ceiling prices paid by pipelines for new gas.

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[1] Section 102 gas is new natural gas including gas from the outer continental shelf. Section 103 gas is from new onshore wells. Both categories are subject to decontrol on January 1, 1985.

[2] Under the NGPA, gas price ceilings in March, 1984 varied from $0.29 to $5.74 per million Btu's, depending on the category (one million Btu's equals 1,000 cubic feet of natural gas. NGPA prices are adjusted monthly to reflect changes in consumer price index.

B. Market Determination of Gas Prices

An alternative explanation to the notion that NGPA regulated price ceilings are controlling current gas prices to industrial users is that gas prices are determined by market forces. Evidence supporting this hypothesis would be data showing that current gas contract prices to industrial users are below what NGPA regulations allow. Natural gas decontrol would have little or no short-term effect on prices in this instance.

II. What Does The Evidence Show on The Determinants of Gas Prices?

The question of whether gas prices to industrial users are determined by NGPA ceilings or by the market forces of supply and demand can be analyzed by looking at recent gas market conditions.

First, in spite of the continued increase in NGPA price ceilings (Appendix A), the average wellhead price of gas has tended to decline since early 1983. Although the average for 1983 was $2.60, up from $2.46 per mcf. in 1982, wellhead prices have generally tended to fall since February 1983 (see Appendix B). While it did jump to $2.70 in September, the average price had dropped to $2.58 per mcf. by December. The decline in average wellhead prices suggests that prices agreed to in recent contracts are falling below ceiling levels and "market-out" actions by piplines are allowing them to reduce the price paid for gas in existing contracts or stop their purchases altogether. For example, Transco, the major interstate pipeline, has exercised "market-out" provisions in its gas purchase contracts with producers in order to lower the price it pays for Section 102 and 103 gas to $2.80 per MMBtu.

Second, comments by industry officials support the idea that many recently negotiated contracts have been for prices below NGPA ceilings. For example, the chairman of the Natural Gas Committee of the Oklahoma Independent Petroleum Association stated that gas now being sold in Oklahoma is priced at $2.40 to $2.50 per mcf. He added that no $3.00 gas is being sold in Oklahoma, no matter what category it has been given by NGPA.[3]

Third, some industry experts believe that lack of demand by pipelines for new sources of gas will depress prices for some time to come. John Brickhill, Vice President of Foster Associates, a Washington, D.C. energy consulting firm, recently stated that there are currently very few active interstate pipeline buyers. He added that most pipelines will have plenty of gas to meet market needs over the next two years without signing on additional suppliers.[4] If gas market experts such as Mr. Brickhill are correct, there should be little upward pressure on gas prices, even though NGPA price ceilings continue their escalation.

III. What Techniques Can Be Used to Estimate a Fair Market Wellhead Gas Price?

A. The Net-Back Method of Estimating The Fair Market Price of Gas

In principle, determining the price of natural gas which would obtain in a free market is straightforward. Because gas competes directly with No. 6 residual fuel oil in the industrial user market, the price of No. 6 fuel oil is said to set a ceiling on the price industrial users would pay for gas.[5] At any higher price, industrial users would switch to residual fuel oil. Since petroleum products, including residual fuel oil, are decontrolled, their prices are market-determined. Therefore, comparisons between the Btu equivalent price of natural gas (most of which is still subject to regulation) and that of a substitute fuel such as No. 6 fuel oil can shed light on the issue of whether the wellhead price of gas approximates a market price.

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[3] Natural Gas Intelligence, April 9, 1984, p. 8.

[4] Natural Gas Intelligence, Feb. 13, 1984, p. 4.

Comparing the Btu price of gas to that of No. 6 fuel oil involves the following procedure. In 1983, No. 6 fuel oil prices (for oil with greater than 1 percent sulphur) averaged $25.78 per barrel. The price of No. 6 residual fuel oil can be converted to an equivalent price expressed in dollars per million Btu's (MMBtu) by dividing $25.78 by the number of Btu's in a barrel of residual fuel oil. Residual fuel oil consumed by the industrial sector averaged 6.287 MMBtu's per barrel. Thus, the Btu-equivalent price of residual fuel oil was $4.10 per MMBtu ($25.78 - 6.287). There are approximately 1.028 MMBtu's in 1,000 cubic feet of natural gas; therefore, $4.22 per mcf. is equal to $4.10 per MMBtu (1.028 x $4.10 = $4.22). Thus, an industrial user capable of switching between fuel oil and gas would not have been willing to pay more than $4.22 per mcf. for natural gas in 1983. A DOE survey of natural gas prices paid by about 10 percent of U.S. industrial users shows that the average for 1983 was $4.20 per mcf. (Appendix B). If the price had been higher, fuel oil would have been more economical.

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[5] Although some gas purchase controls link gas price escalators to No. 2 fuel oil, it is not appropriate to compare the Btu equivalent price of this fuel oil with that of natural gas. No. 2 fuel oil is a premium petroleum product and is generally not used by industrial users since its price is relatively high.

To complete the computation of the wellhead price of gas, transportation and distribution costs must be deducted. If we assume that transportation costs average $0.40 per mcf. and that distribution costs average $1.00 per mcf., then the free market wellhead price of natural gas would equal $4.22 - $0.40 - $1.00 = $2.82 per mcf. in 1983. In 1983, the average wellhead price was $2.60 per mcf (see Appendix B). The average wellhead price in 1983 ($2.60 per mcf.) reflects both prices for old gas, which are constrained by NGPA price ceilings, as well as recently negotiated contracts, which do not appear to be restrained by NGPA regulations. Judging by the net-back calculation, the 1983 average wellhead price of gas appears to approximate a market-determined price.

Additional evidence that markets are working to determine current gas prices can be seen in the trend of prices for gas purchased by major interstate pipelines. Gas purchase prices have declined from an average of $3.27 per mcf. in January 1983 to $2.73 per mcf. in December 1983, in spite of the continued escalation of NGPA price ceilings (see Appendix B). Again current gas prices appear to be consistent with the results of the "net-back" calculation shown above. Therefore, this analysis supports the conclusion that market forces are the primary determinant of gas sales to industrial users.

B. An Average of Recently Negotiated Contract Prices

An alternative to the "net-back" estimate of a market clearing price for gas is a volume weighted average of recently negotiated contract prices. This approach was incorporated in the Administration's 1983 natural gas decontrol proposals. Such a survey was to have served as a "cap" on prices which might otherwise "fly-up" above the market clearing level as a result of indefinite price escalators. The survey concept subsequently found its way into other decontrol proposals, indicating that the basic approach was acceptable to others.

In order to conduct a survey of recently negotiated wellhead prices for gas provided to industrial users, an examination of contracts on file at FERC would be necessary. The agency's Form 155 contains data on the price paid by a pipeline for gas to be sold to industrial users. That information, combined with the pipeline's most recent Purchase Gas Adjustment would permit the calculation of a range of prices representing current gas market conditions.

Preliminary analysis of recent gas purchase contracts on file at FERC indicates that most wellhead prices are falling within the range of $2.70 to $3.00 per mcf. Thus, the price calculated using the "net-back" method (illustrated in Section III. A.) appears to be a close approximation of current wellhead prices for natural gas.

IV. What Does The Future Hold for Natural Gas Prices?

Given the decline in gas prices in the last year and the fact that a significant surplus of deliverability still exists (1.7 trillion cubic feet or 10 percent of U.S. gas consumption in 1983), it is unlikely that gas prices will increase significantly in 1984 or upon decontrol in 1985.[6] Thus, the current price appears to approximate the market clearing price which would occur after decontrol takes place, particularly with regard to Section 102 and 103 gas.

Although the current average wellhead price reflects the market clearing level, it is important to realize that it is an average. Price variations also exist among states with respect to the average wellhead price of gas within each state. This variation reflects several factors including: (1) the mix of regulation-defined gas categories in each state; (2) closeness to the points of consumption; and (3) the geographic concentration and nature of gas resources. These factors will affect actual market clearing prices at the wellhead in each producing state, as well as delivered prices to industrial users in the future. This simply means that price uniformity is unlikely to develop under either market forces or regulated prices.

It nevertheless appears that market clearing prices for industrial users will continue to predominate for the foreseeable future, even on a state-by-state basis. Losses of gas sales to industrial users which switch to other fuels due to price, or move offshore for cheaper gas, will have a more significant short-term impact on residential gas prices than will regulation. Residential users would be charged a higher share of fixed costs for transportation and distribution, thereby raising their delivered price even if wellhead prices remained relatively unchanged.

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[6] Natural Gas Monthly, Energy Information Administration, U.S. Dept. of Energy, p. 45, March 1984.

Appendix A: Natural Gas Policy Act of 1978 Price Ceilings

Industry Overview

Table 20. Natural Gas Ceiling ices by Category of Gas, Type of Sale or COntract[a]
(Dollars per Million Btu)

	March 1984	March 1983	March 1982	March 1981	March 1980	March 1979
Section 102						
New Natural Gas, Certain OCS Gas	3.632	3.344	3.063	2.729	2.404	2.136
Section 103						
New Onshore Production wells	2.869	2.742	2.608	2.406	2.188	2.006
Section 108(b)(1)(B)						
Alternative Maximum Lawful Price for Certain Intrastate Rollover Gas[b]	1.638	1.585	1.486	1.373	1.287	1.164
Section 107						
High-Cost Gas (Deep Gas)[c]	--	--	--	--	--	2.136
Gas Produced From Tight Formations[d]	5.738	5.484	5.216	4.812	4.376	--
Section 108						
Stripper Gas	3.891	3.583	3.281	2.922	2.373	2.285
Section 109						
Not Otherwise Covered	2.375	2.270	2.158	1.993	1.812	1.661
Sections 104 and 106(a)						
Post-1974 Gas, All Producers	2.375	2.270	2.158	1.993	1.812	1.661
1973-1974 Biennium Gas:						
Small Producer	2.011	1.922	1.826	1.685	1.532	1.405
Large Producer	1.535	1.469	1.398	1.291	1.176	1.078
Interstate Rollover Gas[e]						
Small Producer	.892	.843	.798	.741	.720	.715[e]
Large Producer	.882	.843	.798	.736	.669	.615
Replacement Contract Gas or Recompletion Gas[a]						
Small Producer	1.128	1.080	1.026	.946	.859	.786
Large Producer	.864	.825	.784	.722	.657	.600
Flowing Gas						
Small Producer	.570	.543	.517	.479	.437	.401
Large Producer	.482	.461	.439	.405	.367	.338
Certain Permian Basin Gas:						
Small Producer	.674	.644	.612	.563	.512	.471
Large Producer	.593	.566	.537	.495	.449	.413
Certain Rocky Mountain Gas:						
Small Producer	.674	.644	.612	.563	.512	.471
Large Producer	.570	.543	.517	.479	.437	.401
Certain Appalachian Basin Gas:						
North Subarea Contracts dated after Oct. 7 1969	.539	.512	.487	.450	.409	.374
Other Contracts	.500	.479	.457	.423	.385	.350
Minimum Rate Gas: All Producers (dollars per Mcf)	.294	.282	.269	.248	.224	.206

[a] See Explanatory Note 10 for discussion of Title I of the Natural Gas Policy Act.

[b] Section 271.602(a) of the NGPA provides that for certain gas sold under an intrastate rollover contract, the maximum lawful price is the higher of the price paid under the expired contract, adjusted for inflation or an alternative Maximum Lawful Price specified in this table. This alternative Maximum Lawful Price for each month appears in this row.

[c] Commencing November 1, 1979, the price of natural gas finally determined to be eligible as deep high-cost gas is deregulated.

[d] The maximum lawful price for tight formation gas applies on or after July 16, 1979.

[e] The price for interstate rollover gas is the higher of the price listed in this table or the just and reasonable price under the expired contract as adjusted for inflation.

--Not applicable.

Note: Geographic coverage is the 50 States and the District of Columbia. A "small producer" is one with annual sales subject to FERC jurisdiction not in excess of 10 Bcf.

Source: Federal Register, "Rules and Regulations."

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Source: Natural Gas Monthly
Energy Information Administration. U.S. Dept. of Energy

Appendix B: Natural Gas Prices

Price

National Average Natural Gas Prices

		Wellhead Price	Imports by Major Interstate Pipeline Companies	Purchased from Producers by Major Interstate Pipeline Companies	Industrial Sales by Major Interstate Pipeline Companies	Purchased by Electric Plants[1]	Residential Price[2]
		Dollars per thousand cubic feet					
1973	AVERAGE	0.22	NA	NA	NA	0.25	1.29
1974	AVERAGE	0.30	NA	NA	NA	0.40	1.43
1975	AVERAGE	0.45	NA	NA	NA	0.77	1.71
1976	AVERAGE	0.58	NA	NA	NA	1.06	1.98
1977	AVERAGE	0.79	NA	NA	NA	1.33	2.35
1978	AVERAGE	0.91	2.21	0.83	1.54	1.48	2.56
1979	AVERAGE	1.18	2.60	1.22	2.01	1.80	2.98
1980	AVERAGE	1.59	4.43	1.63	2.54	2.28	3.68
1981	AVERAGE	1.98	4.89	2.16	3.13	2.81	4.29
1982	January	2.23	4.96	2.38	3.59	3.07	4.65
	February	2.30	4.92	2.48	3.58	3.18	4.69
	March	2.35	4.89	2.38	3.61	3.25	4.78
	April	2.40	5.06	2.44	3.61	3.32	4.96
	May	2.45	4.93	2.63	3.62	3.42	5.17
	June	2.45	4.86	3.06	3.66	3.57	5.20
	July	2.47	5.00	2.79	3.71	3.69	5.23
	August	2.53	5.07	2.84	3.75	3.67	5.23
	September	2.58	5.05	2.90	3.88	3.67	5.41
	October	2.60	5.02	2.97	3.91	3.68	5.66
	November	2.62	5.01	3.02	3.98	3.81	5.68
	December	2.62	4.97	3.19	4.00	3.64	5.74
	AVERAGE	2.46	4.97	2.75	3.72	3.49	5.17
1983	January	2.63	5.03	3.27	4.32	[1]3.57	5.84
	February	2.64	5.09	3.15	4.33	3.41	5.85
	March	2.61	5.01	3.08	4.23	3.44	5.94
	April	2.57	4.66	2.90	4.37	3.34	6.04
	May	2.56	4.40	3.03	4.24	3.54	6.20
	June	2.62	4.41	2.93	4.22	3.58	6.18
	July	2.58	4.31	2.98	4.24	3.72	6.19
	August	2.61	3.93	2.90	4.23	3.75	6.16
	September	2.70	4.02	2.87	4.07	3.70	6.16
	October	2.61	4.03	2.66	4.22	3.60	6.06
	November	2.58	4.26	2.84	4.26	3.53	6.02
	December	2.58	4.33	2.73	4.12	3.49	6.03
	AVERAGE	2.59	4.56	2.94	4.26	3.58	[3]5.98
1984	January	NA	NA	NA	NA	NA	5.96
	February	NA	NA	NA	NA	NA	5.99

The Bureau of Labor Statistics residential price series has been replaced with Energy Information Administration data and estimates. See Notes and Sources on pages 95 through 97.

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[1] Data through December 1982 cover all steam-electric and gas turbine engine electric utility generating plants with a capacity of 25 megawatts or greater. Beginning with January 1983, data cover steam-electric utility generating plants with a combined capacity of 50 megawatts or greater. Small quantities of coke oven gas, refinery gas, and blast furnace gas are included.

[2] Monthly residential prices are EIA calculations. See Note 9 on last pages of this section for estimation procedures.

[3] Preliminary estimate. NA = Not available.

Notes: • Geographic coverage is the 50 States and the District of Columbia.

• Data for 1973 through December 1982 are final. All other data are preliminary unless otherwise indicated.

Sources: • See the last pages of this section.

Monthly Energy Review
Energy Information Administration, U.S. Dept. of Energy

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Mr. **Florio**. Thank you very much. Mr. Misbrener.

STATEMENT OF JOSEPH M. MISBRENER

Mr. **Misbrener**. Thank you, Mr. Chairman. I am Joseph Misbrener, president of the Oil, Chemical and Atomic Workers International Union, representing over 110,000 workers in some 48 states. I have with me, Mr. Chairman, our legislative director, Nola Hancock.

I will summarize my written statement and ask that it be included in the record.

I am also, as Mr. Millian indicated, the co-chairman of the petrochemical trade group, which is a coalition of labor and business that supports fair international competition in the energy-intensive products. My comments today will focus on the human cost of competition with unfairly subsidized imports. They will stem from the experience of our members in the petroleum refining, ammonia, and uranium industries.

Mr. Chairman, I have also attached to my written statement a list of plant closings affecting our membership, and the number of jobs that have been lost since 1980 to unfair competition.

In 1981 our members was 156,000; today it has fallen to 110,000. By our account, over 22,000 of these jobs have been permanently lost. It is common knowledge that the U.S. employs world class technology in its petroleum refining and petrochemical industries. The Oil and Gas Journal states that the U.S. refining industry is the most sophisticated in the world and the world leader in refinery technology.

American workers in energy-intensive industries are not competing against superior technology, or more productive workers overseas. Instead, our workers are competing against foreign governments that subsidize the energy inputs of export products. Or in the case of uranium, the price of the exported energy product.

Since 1980, the U.S. refining industry has declined from 18 million barrels per day of operating refinery capacity to 14 billion barrels per day of operating refinery capacity; a 22 percent reduction.

The Department of Labor estimates that there are slightly over 20,000 fewer jobs in the U.S. refining industry today than there were at the end of the 1980. The impact of this job loss has multiplied throughout the regions where it occurs. For example, when Texaco recently cut its production in half at Port Arthur, TX, 1,400 of our members, Texaco employees, were laid off. Texaco estimated that the elimination of one refinery job in Port Arthur resulted in the elimination of 5 additional jobs locally, and up to 13 additional jobs in the State.

The Pace Co. of Houston, TX, estimates in a recent study that total job loss due to import-related refinery shutdowns could be as high as 62,000 jobs by 1990. We ask, Mr. Chairman, that a copy of the Pace study be included in the record.

Ammonia is another product essential to our economy. It is the source of nitrogen fertilizers, indispensible to the U.S. farm productivity. Like refining, ammonia production is energy intensive. Natural gas is used to make ammonia and its cost accounts for some 75 percent of the cost of making ammonia. Ammonia production requires highly skilled workers, as does refining. Again, the major cause of the disruption in this industry was government involvement. Imports from the Soviet Union and Mexico, nations which use a two-tiered natural gas price system, selling cheaply to themselves and exporting at market prices, has driven down the price of ammonia on the U.S. Gulf Coast to below the cost of natural gas incurred by most U.S. producers.

The number of operating U.S. ammonia plants fell from 100 in 1981 to about 80 today. Several thousand workers, many of them members of my union, have been laid off or have lost their jobs.

The domestic uranium industry has also suffered severely because of subsidized imports. Approximately 20,000 men and women, 90 percent of the uranium work force in the United States, have been laid off, many in recent months.

Foreign governments heavily support and subsidize their own uranium industry. They sell their surpluses here at prices below those in the home markets, and they pour hundreds of millions in government cash into their uranium development project.

It is imperative that action be taken to guard American workers and the industries they operate, when unfair trade practice threatens their rightful security. We are not asking for protectionist barriers; we are asking for a chance to compete. We believe that the enactment of H.R. 1950, H.R. 2451, H.R. 2345 and Senate bill 1292 would provide the minimum safeguards required to eliminate distortion and diversion in world petroleum and refinery products over the short term and would increase the influence in market forces and protect U.S. national security into the 1990's. Thank you, Mr. Chairman.

[Testimony resumes on p. 235.]

[The prepared statement of Mr. Misbrener follows:]

Statement of Joseph M. Misbrener
on behalf of the
Oil, Chemical and Atomic Workers International Union
and the
Petrochemical Trade Group
before the
Subcommittee on Commerce, Transportation and Tourism
House Energy and Commerce Committee

June 26, 1985

Mr. Chairman and Members of the Subcommittee:

I am Joseph M. Misbrener, President of the Oil, Chemical and Atomic Workers International Union (OCAW), representing over 110,000 workers in 48 states. I am also the Co-chairman of the Petrochemical Trade Group, a coalition of labor and business that supports fair international competition in energy-intensive products. With me today is Kenneth Y. Millian, Vice-president, Corporate Administration and Director of Government Relations for W.R. Grace & Co. Grace is a major ammonia producer and also a member of the Petrochemical Trade Group. Specifically, we will speak to the necessity of adopting H.R. 1950, the Trade Law Modernization Act of 1985, introduced by Reps. Frank Guarini and John Duncan. We feel strongly that such legislation is vital to the effort to offset the impact of unfairly subsidized imports on American workers and industries.

Mr. Chairman, we congratulate you for holding these hearings on the serious problems facing U.S. workers and industries on the international competitive front. My comments today will focus on the human cost of competition with unfairly-subsidized imports. My comments stem from the experiences of OCAW members in the petroleum refining, ammonia and uranium industries. These industries are based on crude oil, natural gas and uranium, and affect employment in the exploration for and production of these natural energy resources. In addition, these industries create many other jobs in supply, service and construction industries.

The Human Cost of Unfair Competition

Mr. Chairman, I want to give you a snapshot of what is happening to our union in the major industries where we represent workers. I have attached to my testimony a list of plant closings affecting OCAW members and the number of OCAW jobs lost since 1980 to unfair competition.

In 1981 our membership was 156,000. Today it has fallen to 110,000. By our account, over 22,000 of these jobs have been permanently lost. Roughly 9,000 jobs in the energy industries, 9,000 jobs in chemical industries and 4,000 jobs in other industries comprise this total. What has happened to OCAW members is indicative of the suffering imposed upon the workforce at large by the increasing problem of subsidized imports.

In Louisiana, Texas, Oklahoma, Pennsylvania and other states, subsidized imports can affect whole communities whose economies revolve around energy resources and energy-intensive products. In Wyoming, Utah, Colorado and New Mexico, the impact of subsidized uranium imports has nearly wiped out employment in the uranium extraction industry.

The loss of a refinery or a nitrogen fertilizer plant has a high multiplier effect on unemployment in surrounding areas. These industries are capital-intensive with very high labor productivity rates. Obviously, such industries generate many more jobs than they provide directly.

It is common knowledge that the United States employs world class technology in its refining and petrochemical industries. The Oil & Gas Journal states that the U.S. refining industry is the most sophisticated in the world and the world leader in refining technology. The United States has sold turnkey technology in ammonia and other basic petrochemicals to other nations. That technology is already in place here. American workers in energy-intensive industries are not competing against superior technology or more productive workers overseas. Instead, our workers are competing against foreign governments that subsidize the energy inputs of export products, or, in the case of uranium, the price of the exported energy product.

Superior technology and productivity cannot overcome the advantage of below-market-priced energy. Neither can such achievements compete against the two-tier pricing policies of foreign government energy monopolies that sell cheap energy to themselves while exporting energy at market prices. Our Commerce Department claims that this discriminatory and protectionist practice does not constitute a subsidy. It does not seem to matter that in certain countries that use two-tier pricing, the government and industry are the major energy users. For instance, Petroleos Mexicanos and industry in Mexico consume almost 90 percent of the natural gas produced in Mexico.

If the U.S. government imposed a two-tier pricing system, it would contradict our national energy policy of allowing the marketplace to price energy. However, it seems perfectly above-board for our international competitors to use this system to enter our market and displace our workers. There are times when we ask ourselves why such foreign practices are defended by officials of our government despite their effect on the workers and industries of this nation.

Our nation cannot afford to let its key industries be driven out of business by unfair foreign government policies and practices. We are not playing on a level field of equal competition. Communities and families are suffering as a result. In the case of refined product imports and dependence on foreign uranium, our national security becomes a real concern as well. When we talk about subsidized ammonia imports eroding the U.S. ammonia industry, we are also talking about the adequate supply of nitrogen fertilizer which our farmers literally cannot do without.

The United States has lived through OPEC crude oil price and supply disruptions and has decided to move to a market-based energy pricing policy for both oil and natural gas. This move has squeezed the profit margins of energy-intensive industries in competition with imports from certain nations.

It has also forced American industries to modernize their plants and employ new technologies.

The petrochemical industry in the United States directly employs 300,000 people, but generates jobs for millions of workers in related enterprises. Likewise, the petroleum refining industry generates many more jobs than it provides directly. The multiplier effect in these industries greatly exceeds the standard manufacturing multiplier of roughly four to one. It is estimated that the multiplier effect for energy-intensive industries is about nine to one.

The industry's decline has economically devastated whole communities. Without question, it has had a very serious impact on the employees and their families. The potent combination of high unemployment and community deterioration utlimately leaves in its wake a terrible human toll, visible and increasing rates of alcoholism, suicides, and marital and family problems.

Mr. Chairman, our union represents people. Roughly 10,000 OCAW refinery workers have been laid off. Many of these layoffs are directly due to foreign competition. The situation is compounded when the layoffs result from unfair competition. These people get to feel that they have been abandoned by their own government, or made into pawns in some greater foreign policy game.

Our members are highly skilled employees. Shutting the door on their jobs not only leads to industrial and personal decay, it also forces them to accept jobs, if they can find them, in much lower paying fields -- it would be a blow to anyone's confidence. To make matters worse, the President's proposed budget will do away with needed worker adjustment assistance proposals, making the situation more critical.

Refined Product Imports: Unfair Crude Oil Discounting

Since 1980, the U.S. refining industry has declined from 18 million barrels per day of operating refining capacity to only 14 million barrels per day of operating refining capacity, a 22 percent reduction. This reduction has occurred in two distinct waves.

Until 1982, refinery closings involved mainly the smaller, less efficient topping units. Many of these refineries were children of entitlements programs and could not survive oil decontrol. Today, they have disappeared. About three million barrels per day of capacity were shut down during this period. While these refineries were shutting down, the refining industry invested $12 billion in its remaining facilities to refine greater yields of light products from heavier, less expensive crude oils. The U.S. refining industry emerged from this rationalization and investment period as the most sophisticated refining industry in the world.

However, since 1983, another million barrels per day of refining capacity have been shut down. These shutdowns have involved increasingly sophisticated plants capable of making unleaded gasoline out of heavier crude oils. These shutdowns have mainly occurred in Louisiana, California, Texas and Oklahoma, where crude supplies are readily available and where crude oil market prices are among the lowest in the world. The reason for these shutdowns is that gasoline has been selling for less than its production cost. Thus, for seven of the last nine quarters, most independent and major U.S. refiners have posted significant losses. It is critical to understand that U.S. refinery economics are based on the profitable production of gasoline. Over half of the current output of our refineries is gasoline because the U.S. demand for gasoline is so much greater than gasoline demand in any other world region.

An examination of what has happened since 1983 reveals the growing power of foreign government energy monopolies and their ability to shutdown a strategic U.S. industry. It is estimated that, in 1984, over 60 percent of our gasoline imports came from government owned and assisted refineries. With the sudden emergence of Saudi Arabia as the number three importer of gasoline to the United States and the new OPEC refineries coming on line, we can expect an even greater percentage of our imports to originate from government-controlled or assisted refineries overseas. In addition, tariff and non-tariff barriers in Japan and Western Europe will continue to divert gasoline from its logical markets into the U.S. market. The U.S. tariff on gasoline is 1.25 cents per gallon, a tariff that has not been adjusted since 1958, when gasoline cost about 11 cents a gallon.

This country has got to wake up to the practices of OPEC and other energy-rich governments in the area of refined products. Otherwise we will trade our increased crude oil energy security for a more dangerous dependence on refined products. Crude oil imports do not shut down domestic refineries. Gasoline imports do. OPEC and other governments are moving into refining to evade their own oil production quotas and pricing rules, and in a desperate attempt to make up for lost foreign currency earnings caused by the decline in oil prices. I can't believe that the lessons of 1973 and 1979 will ultimately fail to be translated into the new challenge facing our national security.

Since 1983, gasoline and gasoline blendstock imports have increased by some 167 percent while U.S. refineries have been shutting down. These imports have captured at least six percent of the U.S. market. According to Deputy Energy Secretary Boggs, imports may actually account for eight or nine percent of the U.S. market if all potential blendables were so labeled.

According to Platt's Oilgram, most foreign refiners could not have sold gasoline at a profit in the U.S. market over this period based on the posted market prices of crude oil. How do foreign producers outcompete the most sophisticated gasoline refining industry in the world? They do it by discounting the price of the crude oil that is refined. It can't be done any other way. Meanwhile, they export this same oil to U.S. refiners at higher market prices. Gentlemen, the handwriting is on the wall. Foreign government controlled and assisted refiners are using discriminatory subsidies to penetrate our market.

The Department of Labor estimates that there are 20,400 fewer jobs in the U.S. refining industry today than there were at the end of 1980. The impact of this job loss is multiplied throughout the regions were it occurs. For example, when Texaco cut its production in half at Port Arthur, Texas, 1400 OCAW employees were laid off. Texaco estimates that the elimination of one refinery job in Texas resulted in the elimination of five additional local jobs, and up to 13 jobs in the state.

The Pace Company of Houston, Texas, was recently commissioned by the Independent Refiners Coalition to study the impact of the new OPEC export refineries coming on stream. Pace has estimated that the impact of these new refineries, in conjunction with trade barriers in Europe and Japan, will cause the shutdown of an additional one million barrels a day of U.S. refining capacity in 1985 and 1986. Pace estimates that total job loss due to import-related refinery shutdowns could be as high as 62,000 jobs by 1990. Pace predicts that the loss of these jobs will be concentrated in Pennsylvania, Louisiana, Texas, California and Washington. We respectfully request that a copy of the Pace Study be submitted for the record.

Beyond the human cost of continued shutdowns, there is a national cost in terms of our ability to maintain U.S. energy security. There is no debate over the strategic importance of the refining industry. The taxpayers of this country have already invested over $15 billion in the Strategic Petroleum Reserve to protect us from another crude oil disruption. But the value of this reserve is directly proportional to our ability to convert it into useable products. Analysis clearly demonstrates that our industry is already incapable of processing the SPR at the planned drawdown rate of 4.5 million barrels per day. A study done for DOE states that the U.S. could be "comfortable" with an operating refining capacity of 14.9 million barrels per day at 85 percent capacity utilization. As I stated, we are now at 14 million barrels per day of operating capacity and the utilization rate is 85 percent. How much farther is this going to go before responsible officials take action? How many more refining jobs will be lost and at what cost to the national security? In the last week of May, imports of finished gasoline, not including the large quantities of the blendstocks which are imported and mixed together to make more gasoline, reached an unprecedented 736,000 barrels per day. That is 11 percent of total domestic consumption. In general, finished gasoline imports are up over 27 percent from this time last year, while U.S. gasoline demand has increased only 2.3 percent. If verifiable blendstocks are included, the increase is even larger.

The decline of the U.S. refining industry is not due to wage rates in the industry. John R. Hall, Chairman of Ashland Oil, Inc., an independent U.S. refiner, recently testified that wage rates for American refinery workers comprised a very small percentage of refining costs and played no part in refinery shutdowns in this country.

Ammonia Imports: Government-subsidized Natural Gas

Ammonia is another product essential to our economy. It is the source of nitrogen fertilizers indispensible to U.S. farm productivity. Like refining, ammonia production is energy intensive. Natural gas is used to make ammonia and its cost accounts for 75 percent of the cost of making ammonia. Ammonia production requires highly skilled workers, as does refining. And, as in the refining industry, the cost of the labor input to ammonia production is very low and has played no part in the shutdown of about 13 percent of U.S. ammonia capacity since 1981.

During 1982 and 1983 the Farm Payment In Kind (PIK) program reduced significantly the acreage of wheat and corn crops requiring nitrogen fertilizers. The U.S. ammonia industry drastically reduced its production due to the ensuing demand decline. But imports surged. Between 1982 and 1983, the net nitrogen trade deficit quadrupled from 200,000 tons to 800,000 tons. A Department of Agriculture official estimated that imported nitrogen comprised 23 percent of farmers' nitrogen supply in 1983. In 1984 that percentage must have increased greatly.

Again, the major causes of the disruption was government involvement. Imports from the Soviet Union and Mexico, nations which use two-tier natural gas price systems -- selling cheaply to themselves and exporting at market prices -- drove down the price of ammonia on the U.S. Gulf Coast to below the cost of natural gas incurred by most U.S. producers. The number of operating U.S. ammonia plants fell from 100 in 1981 to about 60 today. Several thousand workers, many of them members of my union, have been laid off or have lost jobs. The impact has been concentrated in the Gulf Coast region. We are now beginning to see rapidly increasing imports of urea, an ammonia-based nitrogen fertilizer, from East Germany and Romania. The result of all this subsidized competition is that the U.S. nitrogen trade deficit increased tenfold from 1982 to 1984, to over two million short tons.

The experience of the ammonia industry and competition with foreign government-owned and controlled exporters foreshadows an increase of similar competition for the ethylene derivative and methanol industries. The decline of these basic petrochemical industries in the United States will be followed by the decline of specialty petrochemicals as the foreign governments expand their operations based on low-priced natural gas. Since specialty petrochemical production requires a larger workforce in proportion to output, the jobs of more skilled workers are threatened.

It is ironic that the World Bank, the United Nations and the American Gas Association have released studies which indicate that the United States is perhaps the best location in the Free World for the addition of new ammonia capacity. The advantages of low-priced gas in developing and remote country locations are offset by the U.S. advantages of better efficiency, lower capital and construction costs, higher productivity and location to serve the U.S. market. But no U.S. ammonia company or farm cooperative can afford to invest over $200 million in a new ammonia plant to have it shut down by low-priced subsidized imports.

Only about 40 percent of world ammonia capacity was controlled by governments in 1970. Today that government control extends over nearly 70 percent of world ammonia capacity. U.S. ammonia producers, no matter how efficient, cannot compete with government subsidized exporters who can price their excess production low enough to be sold in our market -- no matter what price it takes.

Uranium Imports: Government-subsidized Resources

The domestic uranium industry has also suffered severely because of subsidized imports. Our union represents about 10,000 workers in the nuclear industry, including groups employed in the production, extraction and mining of uranium. Approximately 20,000 men and women -- ninety percent of the uranium workforce -- have been laid off, many in recent months. Several hundred OCAW members have been laid off. At last count, 19 out of the 24 mills were shut down or on standby. The remaining five were operating at reduced capacity. Further cutbacks and more layoffs lay ahead. The scheduled shutdown of the gaseous diffusion uranium enrichment facility at Oakridge, Tennessee will result in the loss of 1,100 OCAW jobs and 1,700 jobs in total.

This situation has been devastating to many communities in New Mexico, Wyoming, Utah and Colorado. More than 50 percent of the nation's uranium was produced in a 15-mile radius around Grant and McKinley counties in New Mexico. In 1979, 17 mines were operating in those counties, employing about 10,000 miners. There were many support businesses providing drilling equipment, supplies and other services. Today, only two companies remain in operation and all the exploration companies have moved out. Subsidized imports have more than doubled since the 1979-1981 period, from an average of 4.4 million pounds to an average of 11.6 million pounds in 1982-1984.

Uranium consumption is at an all time high in the United States. Almost all new contracts for uranium use now involve foreign suppliers. The feed requirements for our enrichment plants are more than four times greater than our domestic production. There are three basic reasons for this disparity.

First, almost all new purchases of uranium by American utilities are from foreign sources such as Canada, South Africa and Australia. Until 1978, foreign source material could not be enriched in domestic facilities for domestic use. The Atomic Energy Commission phased out this limitation between 1978 and 1983. Second, DOE's over-optimistic estimates of uranium needs encouraged overproduction. Inventories need to be worked down. Third, DOE's changes in enrichment policies will deliver more fuel to the utility customers than is delivered to the enrichment plants. This difference is being made up out of government stockpiles at less than market price. This puts DOE in direct competition with domestic producers.

Foreign governments heavily support and subsidize their own uranium industries. The sell their surpluses here at prices below those in the home markets and the pour hundreds of millions in government cash into their uranium development projects.

DOE tries to claim that imports are not the reason for the U.S. industry's demise. Their position, in our opinion, is indefensible. Imports now dominate our market.

Recommendations

It is imperative that action be taken to guard American workers and the industries they operate when unfair trade practices threaten their rightful security. We are not asking for protectionist barriers. We are asking for a fair chance to compete.

Reps. Frank Guarini and John Duncan have introduced the Natural Resource Subsidy provision in the Trade Law Modernization Act of 1985, H.R. 1950. This legislation is strongly supported by the Petrochemical Trade Group. It has been sponsored and supported by the Labor Industry Coalition for International Trade (LICIT). The member companies and unions of these broad coalitions believe that this legislation is essential to the modernization of U.S. trade laws in a number of critical respects.

In the House of Representatives, Rep. Sam Gibbons has introduced the Resource Input Subsidy Act, H.R. 2451, similar to the House-passed Natural Resource Subsidy legislation he sponsored last year but with an injury test added. In addition, Rep. Henson Moore has introduced a similar provision without the injury test, H.R. 2345. On the Senate side, we commend and support Senators Baucus and Long in their newly-introduced legislation, S. 1292, to impose countervailing duties when natural resource input subsidies are used by foreign governments to unfairly penetrate the U.S. market.

The natural resource subsidy legislation would successfully address the problem of two-tier pricing as it affects petrochemicals like ammonia. It would also provide a long-term solution to the practice of discounting crude oil to refineries at discriminatory below-market prices. However, it will not require Europe and Japan to lower or eliminate their discriminatory trade barriers over the short term. These barriers will cause an unwarranted decline in U.S. refining capacity from new OPEC refined product exports. For this reason, the natural resource bills do not fully address the dangers facing the domestic refining industry.

There is not sufficient time to prevent irreparable injury to the domestic refining industry through traditional unfair trade remedies, even if the trade laws are reformed and strengthened. While improvement of the trade laws is being considered by Congress, we believe the Administration should take immediate steps to limit gasoline imports, or take other actions as appropriate, to assure adequate refining capacity pursuant to the President's national security powers.

We further believe that the Congress should take prompt action specifically regarding gasoline imports. In this regard, we recommend adoption of Rep. Beryl Anthony's bill, H.R. 2354, which incorporates the recommendations from the recent ITC study and imposes an increased two-tier tariff on imported gasoline and gasoline blendstocks at an ad valorem rate. This bill would provide an interim remedy to meet national security requirements and offset the diversion of gasoline from Japan and the EC by reason of their tariff and non-tariff barriers. Finally, the Congress should take prompt action to close the loopholes on fuel grade ethanol and gasohol imports.

We believe these actions are the minimum required to eliminate distortion and diversion in world petroleum and refined petroleum product markets over the short term, and to increase the influence of market forces and protect U.S. national security into the 1990's.

Concerning uranium, we urgently need legislation that clearly provides that a specific license is required to import foreign uranium. We would urge the Congress to reduce imports of uranium to no more than 20 percent of domestic use. In deciding whether to grant such a license, the agency must be required to consider its impact on the community, its schools and other services, our uranium miners and other workers supported by uranium mining, the states and the domestic producers. Such licenses should not be granted unless the industry is restored to a condition where it can meet U.S. uranium needs. This approach would not put DOE at a competitive disadvantage for enrichment services. Foreign source material which is enriched at foreign facilities should require similar licenses.

PERMANENT PLANT CLOSINGS
JANUARY 1980 - APRIL 1985
DOES NOT INCLUDE LAYOFFS DUE TO SEASONAL
OR TEMPORARY MARKET CONDITIONS

LOCAL	COMPANY	LOCATION	DATE SHUTDOWN	PARTIAL OR COMPLETE	WEEKS OF NOTICE	JOBS LOST AT CLOSE AND 2 YEARS PRIOR	PRODUCT LINE	PRODUCT CATEGORY	RUNAWAY PLANT
1-5	FILTER PROD.	RICHMOND, CA	10/83	C	48	9	FOOD FILTERS	MISC.	NO
1-5	J R SIMPLOT	LATHROP, CA	1/83	P	9	170	FERTILIZER	CHEMICAL	NO
1-19	CONTINENTAL CARBON	BAKERSFIELD, CA	9/81	C	4	27	CARBON BLACK	CHEMICAL	PONCA CITY, OK*
1-19	TOSCO CORP. **	BAKERSFIELD, CA	11/83	C	9	200	OIL REFINING	ENERGY	N/A
1-19	WEST COAST OIL	BAKERSFIELD, CA	4/81	C	0	37	OIL REFINING	ENERGY	NO
1-128	SHELL CHEMICAL	DOMINGUEZ, CA	5/83	P	9	27	PETROCHEMICALS	CHEMICAL	DPARK,TX-WOODRVR,IL*
1-128	GOLDEN EAGLE REF.	WILMINGTON, CA	1/85	C	N/A	19	OIL REFINING	ENERGY	NO
1-128	NATIONAL SUPPLY CO.	TORRANCE, CA	2/85	C	N/A	180	OIL & GAS DRIL MCHNE	MISC.	NO
1-547	MIRRA COTE CO	EL SEGUNDO, CA	10/80	C	8	80	PLASTICS	CHEMICAL	NO
1-547	WILSHIRE PRODUCTS	COMPTON, CA	10/80	C	8	26	PLASTICS	CHEMICAL	NO
1-591	MELCO MFG.	OAK HARBOR, WA	12/84	C	N/A	92	PRINTED CIRCUIT BDS.	MISC.	NO
1-592	P&M COAL (GULF OIL)	FORT LEWIS, WA	11/81	C	17	105	R&D COAL REF.	ENERGY	WEST VIRGINIA
# GROUPS									
	12					972			
2-124	GREAT LAKES CARBON	CASPER, WY	4/83	C	9	15	PETRO. COKE	CHEMICAL	NO
2-230	TEXACO	CASPER, WY	8/82	C	26	145	OIL REFINING	ENERGY	AMARILLO & OTHER
2-373	HUSKY OIL	CODY, WY	11/82	C	28	79	OIL REFINING	ENERGY	N/A
2-470	UNION TANK CAR	LAUREL, MT	7/83	P	N/A	17	TANK CAR REPAIR	MISC.	N/A
2-477	SHATTUCK CHEMICAL	DENVER, CO	5/84	C	N/A	55	MOLYBDENUM URANIUM	CHEMICAL	NO
2-477	SHELL CHEMICAL	DENVER, CO	12/82	C	30	125	PESTICIDES	CHEMICAL	GULF COAST LOC.
2-632	RALSTON PURINA	POCATELLO, ID	11/84	C	N/A	10	ANIMAL FEED	MISC.	NO
2-655	GARY REFINING	FRUITA, CO	4/85	C	N/A	190	OIL REFINING	ENERGY	NO
2-708	QUIVIRA	GRANTS, NM	3/85	C	N/A	271	URANIUM MINE	ENERGY	NO
2-708	RESERVE OIL & MIN.	GRANTS, NM	5/80	C	1	24	URANIUM ORE	ENERGY	NO
2-644	COTTER CORP.	CANON CITY, CO	1/85	C	N/A	55	URANIUM MILL	ENERGY	NO
# GROUPS									
	11					986			

LOCAL	COMPANY	LOCATION	DATE SHUTDOWN	PARTIAL OR COMPLETE	WEEKS OF NOTICE	JOBS LOST AT CLOSE AND 2 YEARS PRIOR	PRODUCT LINE	PRODUCT CATEGORY	RUNAWAY PLANT
3-94	TRUE TAGG PAINT	MEMPHIS, TN	8/83	C	13	10	PAINTS	CHEMICAL	NO
3-116	SOUTHERN WOOD PIEDMONT	EAST POINT, GA	12/84	C	N/A	22	CRECSOTING OF TIES	MISC.	NO
3-265	INT'L. MINERALS & CHEM.	GREENVILLE, TN	6/84	C	N/A	15	FERTILIZER	CHEMICAL	NO
3-180	BASF-WYANDOTTE	HUNTINGTON, WV	4/81	P	52	175	DYES & PIGMENTS	CHEMICAL	HOLLAND, MI
3-288	UNION CARBIDE	OAK RIDGE, TN	9/81	P	N/A	400	URAN ISOT 235	ENERGY	NO
3-300	RING AROUND PROD.	MONTGOMERY, AL	8/82	C	8	10	CHEM. TRT SEEDS	CHEMICAL	NO
3-300	ROYSTER CO	MONTGOMERY, AL	6/80	C	0	10	FERTILIZER	CHEMICAL	NO
3-418	PENNZOIL	FALLING ROCK, W.VA	3/83	C	30	104	PETRO. REFINING	ENERGY	NO
3-523	ALLIED CHEMICAL	E. ASHLAND, KY	10/81	P	N/A	275	COKE	CHEMICAL	NO
3-543	ALLIED MILLS	PORTSMOUTH, VA	3/81	C	20	21	ANIMAL FEED	MISC.	NO
3-543	GULF OIL	S. NORFOLK, VA	11/83	C	26	19	OIL PROD TERM	ENERGY	NO
3-550	UNION CARBIDE	PADUCAH, KY	1/82	P	N/A	400	URAN ISOT 235	ENERGY	NO
3-552	IRONTON COKE	IRONTON, OH	4/82	C	0	454	COKE	CHEMICAL	NO
3-611	BORDEN CHEMICAL	CHESAPEAKE, VA	7/81	C	11	200	FERTILIZER	CHEMICAL	NO
3-960	SANCHEZ (GEN METAL)	JONESBORO & ERWIN,TN	7/82	C	N/A	139	AUTO PTS.-STOVES	MISC.	NO
# GROUPS 15						2,254			
4-23	TEXACO	PORT ARTHUR, TX	82/83	P	8	1,330	OIL REF-LUBE OILS	ENERGY	VARIOUS*
4-153	PPG INDUSTRIES	CORPUS CHRISTIE, TX	11/82	C	9	20	CHROME CHEM	CHEMICAL	NO
4-207	CRYSTAL OIL CO	LONGVIEW, TX	3/82	C	8	64	OIL REFINING	ENERGY	NO
4-208	AMERICAN CYANAMID	FORT WORTH, TX	6/83	C	16	120	CATALYSTS	CHEMICAL	N/A
4-208	DRACKETT INC	FORT WORTH, TX	10/80	C	6	34	HOUSEHOLD CLEANERS	CHEMICAL	NO
4-227	AMER THERMOPLASTICS	HOUSTON, TX	3/83	C	4	48	PLASTICS COMP.	CHEMICAL	HOUSTON, TX
4-227	TRIANGLE PWC	HOUSTON, TX	10/82	C	13	44	PLAS. PIPE COATING	CHEMICAL	N/A
4-228	TEXACO	PORT NECHES, TX	11/82	P	8	81	OIL REF(ASPHALT)	ENERGY	PORT ARTHUR, TX*
4-243	OHMSTEDE MACHINE	BEAUMONT, TX	4/84	C	N/A	80	MACHINE SHOP	MISC.	NO
4-243	PPG INDUSTRIES	BEAUMONT, TX	80-83	P	4	180	TETRAETHYL LEAD	CHEMICAL	NO
4-243	SOUTH HAMPTON CO	SILSBEE, TX	12/82	C	N/A	33	OIL REFINING	ENERGY	NO
4-245	BAYOU STATE OIL	HOSSTON, LA	2/82	P	4	27	OIL REFINING	ENERGY	NO
4-245	BAYOU STATE OIL	HOSSTON, LA	2/82	C	4	3	OIL PROD TERM	ENERGY	NO
4-343	CPC INC	CORPUS CHRISTI, TX	2/80	C	11	230	CORN MILLING	MISC.	STOCKTON, CA
4-367	PASADENA CHEM(MOBIL)	PASADENA, TX	12/80	P	3	46	FERTILIZER	CHEMICAL	NO
4-447	CHARTER MARKETING	HAMMOND, LA	5/82	C	16	17	TBA WAREHOUSE	MISC.	NO
4-447	HUNT WESSON	HARVEY, LA	12/80	C	18	6	VEGETABLE OILS	MISC.	NO
4-449	WEST GULF MARINE	GALVESTON, TX	12/81	C	8	50	BARGE BUILDING	MISC.	NO
4-463	PHILLIPS CHEMICAL	BORGER, TX	9/84	C	N/A	203	POLYMERS	CHEMICAL	NO
4-471	DORCHESTER GAS	MT. PLEASANT, TX	10/84	C	N/A	133	OIL REFINERY	ENERGY	NO
4-478	FERTILIZER CO,TX	RANGER, TX	3/81	C	0	31	FERTILIZER	CHEMICAL	PASADENA, TX
4-500	CITIES SERVICE P.L.	LAKE CHARLES, LA	1/84	C	9	20	TANK CAR REPAIR	ENERGY	NO

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LOCAL	COMPANY	LOCATION	DATE SHUTDOWN	PARTIAL OR COMPLETE	WEEKS OF NOTICE	JOBS LOST AT CLOSE AND 2 YEARS PRIOR	PRODUCT LINE	PRODUCT CATEGORY	RUNAWAY PLANT
4-500	CITIES SERVICE	LAKE CHARLES, LA	3/83	C	18	70	BUTADIENE	CHEMICAL	SARNIA, ONTARIO
4-620	GULF WANDES**	BATON ROUGE, LA	7/82	P	0	40	FIBERGLAS DUCTS	CHEMICAL	NO
4-796	PHILLIPS CHEMICAL	CACTUS, TX	11/82	C	13	40	FERTILIZERS	CHEMICAL	N/A
4-955	US STEEL	GEORGE WEST, TX	10/82	P	44	95	URANIUM OXIDE	ENERGY	N/A
4-1600C	ETHYL CORP.	PASADENA, TX	7/81	P	9	210	TETRAETHYL LEAD	CHEMICAL	NO
# GROUPS 27						3,255			
5-107	MILCHEM INC.	MINERAL POINT, MO	8/82	C	4	17	BARITE MILL	CHEMICAL	NO
5-136	KV PHARMACEUTICAL	ST. LOUIS, MO	12/80	C	0	30	PHARMACEUTICALS	CHEMICAL	NO
5-217	HESTON CORP.	CLAREMORE, OK	6/82	C	13	150	FARM EQUIPMENT	MISC.	HESSTON KS.
5-217	TEX PRODUCTS	TULSA, OK	3/83	C	2	25	PAINTS	CHEMICAL	NO
5-217	TEXACO	TULSA, OK	8/82	C	26	284	OIL REFINING	ENERGY	PORT ARTHUR ETC*
5-220	CHAMPLIN PETROLEUM	ENID, OK	2/84	C	9	300	OIL REFINING	ENERGY	NO
5-241	PESTER REF.	EL DORADO, KS	3/85	C	N/A	120	OIL REFINING	ENERGY	NO
5-246	MOBIL OIL	AUGUSTA, KS	9/83	C	26	200	OIL REFINING	ENERGY	NO
5-283	ALLIED MATERIALS	STROUD, OK	12/84	C	N/A	88	OIL REFINING	ENERGY	NO
5-283	HUDSON OIL**	CUSHING, OK	12/82	C	0	140	OIL REFINING	ENERGY	NO
5-348	MOBIL PIPE LINE	MID CONTINENT USA	9/83	C	26	60	OIL PIPELINE	ENERGY	NO
5-348	TEXACO-CITIES SERV.	MIDWEST USA	6/82	P	N/A	45	CRUDE OIL P.L.	ENERGY	NO
5-379	OLIN CORP.	N. LITTLE ROCK, AR	5/80	C	18	21	FERTILIZER WHSE.	CHEMICAL	NO
5-379	OLIN CORP.	N. LITTLE ROCK, AR	1/82	C	2	14	SULFURIC ACID	CHEMICAL	NO
5-379	REICHHOLD CHEMICAL	MALVERN, AR	5/80	C	3	24	RESINS	CHEMICAL	NO
5-385	ANDERSON PRICHARD P.L.	CYRIL, OK	9/84	C	N/A	9	CRUDE OIL PIPELINE	ENERGY	NO
5-385	OKLAHOMA REF.	CYRIL, OK	11/84	C	N/A	71	OIL REFINING	ENERGY	NO
5-498	CKB (OKC-BASIN)	OKMULGEE, OK	7/82	C	0	74	OIL REFINING	ENERGY	NO
5-511	EDWARD R. SPENCE	ST. LOUIS, MO	8/84	C	N/A	16	PLASTIC NOVELTIES	CHEMICAL	NO
5-572	MID AMERICA REF.	CHANUTE, KS	9/81	C	0	30	OIL REFINING	ENERGY	NO
5-604	PHILLIPS PETROLEUM	KANSAS CITY, KS	9/82	C	26	475	OIL REFINING	ENERGY	HOUSTON, TX., ETC.
5-617	CPC INT'L.	N. KANSAS CITY, MO	10/81	P	22	215	CORN PRODUCTS	MISC.	ARGO, IL
5-672	AMOCO OIL	SUGAR CREEK, MO	9/82	C	26	340	OIL REFINING	ENERGY	BEAUMONT, TX, ETC*
5-797	TOSCO	DUNCAN, OK	11/83	C	26	236	OIL REFINING	ENERGY	NO
5-798	CRA INC.	PHILLIPSBURG, KS	10/82	C	26	108	OIL REFINING	ENERGY	NO
5-813	ALLIED CHEMICAL	HELENA, AR	2/82	P	1	80	FERTILIZERS	CHEMICAL	NO
5-813	PENNARK BARGE	HELENA, AR	5/82	C	4	55	BARGES	MISC.	NO
5-857	CONOCO TRANSPORTATION	PONCA CITY, OK	3/85	C	N/A	12	RAIL CAR REPAIR	MISC.	NO
# GROUPS 28						3,239			

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LOCAL	COMPANY	LOCATION	DATE SHUTDOWN	PARTIAL OR COMPLETE	WEEKS OF NOTICE	JOBS LOST AT CLOSE AND 2 YEARS PRIOR	PRODUCT LINE	PRODUCT CATEGORY	RUNAWAY PLANT
6-18	METALIST MAM RESEAR	BUTLER, WI	10/80	C	7	39	MACHINERY	MISC.	NO
6-111	UNDERGROUND ENV.SER	BURLINGTON, WI	3/84	C	9	22	TRENCH CONTRACTOR	MISC.	NO
6-409	RAYETTE FABERGE	ST. PAUL, MN	3/83	C	18	100	TOILETRIES	CHEMICAL	RALEIGH, NC
6-503	FARMLAND INDUSTRIES	FORT DODGE, IA	9/83	P	0	24	AMMONIA	CHEMICAL	KANSAS, OK. PLANTS
6-503	LAND O' LAKES	FORT DODGE, IA	12/83	C	9	32	SOY BEAN MILL	MISC.	NO
6-578	GORDY'S SUPER VALUE	AUSTIN, MN	8/80	C	0	38	GROCERY STORE	MISC.	NO
6-659	CONOCO	WRENSHALL, MN	5/81	C	9	96	OIL REFINING	ENERGY	NO
6-717	GILFILLAN FORD**	HASTINGS, MN	7/82	C	0	10	AUTO DEALERSHIP	MISC.	NO
# GROUPS									
8						361			
7-103	MEADOW GOLD DAIRY	DAYTON, OH	7/82	C	1	31	DAIRY OPERATION	MISC.	WESTERVILLE, OH
7-140	AGA GAS	CLEVELAND, OH	9/83	P	13	9	INDUSTRIAL GASES	CHEMICAL	VARIOUS
7-148	ROYAL GENERAL	CLEVELAND, OH	12/80	C	2	10	PAINT SHOP	CHEMICAL	NO
7-155	R.P. SCHERER	DETROIT, MI	4/81	C	104	350	PHARMA. CAPSULES	CHEMICAL	CLEARWATER, FL
7-176	PARKE DAVIS	DETROIT, MI	7/82	C	104	700	PHARMACEUTICALS	CHEMICAL	PENNA & S.C.
7-210	AGA GAS	HOMEWOOD, IL	2/84	C	14	2	INDUSTRIAL GASES	CHEMICAL	NO
7-210	BARKER CHEMICAL	CHICAGO, IL	5/82	C	0	30	PAINTS	CHEMICAL	NO
7-210	ENERGY COOPERATIVE	E. CHICAGO IND.	3/82	C	9	420	OIL REFINING	ENERGY	NO
7-210	ESTECH CHEMICAL	CALUMET CITY, IL	8/82	C	4	7	SULFURIC ACID	CHEMICAL	NO
7-210	UNION TANK CAR	WHITING, IN	8/80	C	52	158	TANK CAR REPAIR	MISC.	BATON ROUGE, LA*
7-210	UNITECH CHEMICAL	HAMMOND, IN	9/80	C	9	6	FATTY ACIDS	CHEMICAL	NO
7-210	YOUNG METAL PROD.	E. CHICAGO, IN	6/80	C	9	10	STEEL CULVERT	MISC.	NO
7-222	TEXACO	LOCKPORT, IL	10/81	C	28	493	OIL REFINING	ENERGY	LAWRENCEVILLE, IL*
7-224	VELSICOL CHEMICAL	ST. LOUIS, MO	6/80	C	104	250	PESTICIDES (PBB)	CHEMICAL	NO
7-336	LEVER BROS.	HAMMOND, IN	2/81	P	9	500	MARGARINE	MISC.	IL, OH, TX
7-336	STABO FOOD SERVICES	HAMMOND, IN	9/83	C	4	14	CAFETERIA SERVICE	MISC.	NO
7-346	GULF OIL	TOLEDO, OH	8/81	C	26	169	OIL REFINING	ENERGY	NO
7-346	GULF OIL	TOLEDO, OH	11/82	C	26	6	OIL PROD. TERMINALS	ENERGY	NO
7-346	PHILLIPS CHEMICAL	TOLEDO, OH	4/81	C	9	40	CARBON BLACK	CHEMICAL	NO
7-346	USS CHEMICAL	SWANTON, OH	12/82	C	0	25	POLYESTER RESINS	CHEMICAL	NEVILLE IS., PA
7-368	CERTAIN-TEED DAYMOND	LAWRENCEVILLE, IL	7/82	C	17	10	PVC PLASTIC PIPE	CHEMICAL	NO
7-389	ATLANTIC RICHFIELD	DEARBORN, MI	3/80	C	260	35	PETROLEUM PROD MKT	ENERGY	NO
7-389	GULF OIL	NOVI, MI	5/83	C	36	23	PETROLEUM PROD MKT	ENERGY	NO
7-395	STANDARD OIL OF OH	CLEVELAND, OH	12/81	C	9	45	ASPHALT REFINING	ENERGY	NO
7-420	ASHLAND OIL	FINDLAY, OH	5/81	P	9	21	OIL REFINING	ENERGY	CANTON, OH*
7-450	MERIT PACKAGING	CANTON, OH	9/81	C	14	20	HOUSEHOLD CHEMS	CHEMICAL	NO
7-498	NASHUA CO.	CHICAGO, IL	9/82	C	26	160	FRICTION TAPE-ADHESI	CHEMICAL	N/A
7-507	H.B. FULLER	CHICAGO, IL	7/80	C	4	12	ADHESIVES	CHEMICAL	NO
7-507	GATEWAY TERMINALS	STICKNEY, IL	4/82	P	N/A	5	PETRO. PRODS. TERMIN	ENERGY	NO
									NO

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LOCAL	COMPANY	LOCATION	DATE SHUTDOWN	COMPLETE OR PARTIAL	WEEKS OF NOTICE	JOBS LOST AT CLOSE AND 2 YEARS PRIOR	PRODUCT LINE	PRODUCT CATEGORY	RUNAWAY PLANT
7-540	GRATIOT CTY MED FAC	ALMA, MI	1/82	C	20	37	NURSING HOME	MISC.	NO
7-540	PLASTIC FIBER INC.	ITHACA, MI	7/82	C	11	60	PLASTIC AUTO PARTS	CHEMICAL	BROWN CITY, MI
7-540	WHITMAN INDUSTRIES	ITHACA, MI	7/82	C	4	44	PREFAB HOMES	MISC.	N/A
7-581	TROJAN POWDER- INC	WOLFLAKE, IL	12/81	C	4	130	DYNAMITE	CHEMICAL	NO
7-627	BASF-WYANDOTTE	WYANDOTTE, MI	5/80	P	4	767	INDUSTRIAL CHEMS.	CHEMICAL	GEISMAR LA*
7-630	CARBORUNDUM	LOGAN, OH	5/83	C	9	281	GRINDING WHEELS	MISC.	NO
7-631	ATLANTIC RICHFIELD	YOUNGSTOWN, OH	5/82	C	45	4	PETRO. PRODS. TERMIN	ENERGY	NO
7-641	VELSICOL CHEMICAL	MARSHALL, IL	2/80	P	9	83	PESTICIDES	CHEMICAL	NO
7-662	CPC INTERNATIONAL	PEKIN, IL	10/81	P	52	278	CORN MILLING	MISC.	WINSTON/SALEM,NC
7-663	CORN SWEETENERS	GRANITE CITY, IL	1/83	C	9	14	CARAMEL COLORING	MISC.	NO
7-765	DAWES LABORATORIES	CHICAGO HTS., IL	1/80	C	26	48	ANIMAL GROWTH HORMON	CHEMICAL	DAYTON, OH
7-767	KOPPERS CO.	ORRVILLE, OH	2/80	P	9	45	RAILROAD TIES	MISC.	NO
7-776	AMOCO OIL CO.	WOOD RIVER, IL	10/81	P	30	300	OIL REFINING	ENERGY	NO
7-822	SEYMOUR RECYCLING	SEYMOUR, IN	2/80	P	0	10	CHEMICAL DUMP	CHEMICAL	NO
# GROUPS									
	43								
						5,662			
8-1	TEXTRON	EDGEWATER, NJ	11/81	C	4	28	CASTOR OIL PRODUCTS	CHEMICAL	NO
8-2	CENTURY INKS	BELTSVILLE, MD	3/82	C	1	5	PRINTING INKS	CHEMICAL	NO
8-124	BOYLE MIDWAY	CRANFORD, NJ	12/83	C	14	242	HOUSEHOLD PRODUCTS	CHEMICAL	N/A
8-149	BRENT CHEMICAL	MT. VERNON, NY	10/84	C	N/A	10	BREWERY CONSULTANTS	CHEMICAL	NO
8-149	COMBUSTION EQUIP.	BRIDGEPORT, CT	12/80	P	9	61	GARBAGE-SOLID FUEL	ENERGY	NO
8-149	HELENA RUBENSTEIN	EAST HILLS, NY	7/81	C	52	300	COSMETICS	CHEMICAL	NO
8-149	LEONARD SPARK PLUG	EAST ORANGE, NJ	1/82	C	156	11	SPARK PLUGS	MISC.	NO
8-215	ARA SERVICES	TONAWANDA, NY	12/80	C	18	5	PLANT CAFETERIA	MISC.	NO
8-222	NATIONAL GYPSUM	AKRON, NY	12/80	C	4	29	WALLBOARD TAPE	MISC.	NO
8-240	TECHNICAL COATINGS	OAKMONT, PA	11/81	C	26	15	PAINTS	CHEMICAL	NO
8-280	MORAY CHEMICAL	BAYONNE, NJ	12/84	C	N/A	70	DYESTUFFS	CHEMICAL	NO
8-247	NATIONAL GYPSUM	CLARENCE CENTER, NY	1/82	C	1	60	GYPSUM WALLBOARD	MISC.	ALBANY, NY
8-361	CROSS CANDLE (GULF)	LINDEN, NJ	9/80	C	N/A	30	CANDLES	MISC.	DUNMORE, PA
8-366	AMOCO OIL	PROVIDENCE, RI	1/84	P	N/A	10	PETRO. PRODS.TERM	ENERGY	NO
8-366	COMMUNITY OIL	S. PORTLAND, ME	11/84	C	N/A	6	FUEL OIL TERMINAL	ENERGY	NO
8-366	DELAWARE VAL.PROP.	HAMPTON, CT	3/81	C	0	8	PROPANE DRIVERS	ENERGY	NO
8-372	A.P. DESANNO	PHOENIXVILLE, PA	7/83	C	9	106	GRINDING WHEELS	MISC.	SALEM, IL
8-397	AMOCO OIL	CARTERET, NJ	12/83	C	12	12	PETRO. PRODS. WHSE	ENERGY	N/A

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LOCAL	COMPANY	LOCATION	DATE SHUTDOWN	COMPLETE OR PARTIAL	WEEKS OF NOTICE	JOBS LOST AT CLOSE AND 2 YEARS PRIOR	PRODUCT LINE	PRODUCT CATEGORY	RUNAWAY PLANT
8-397	NUODEX	FORDS, NJ	4/85	C	12	2	ORGANIC CHEMICALS	CHEMICAL	NO
8-398	ACME HARDESTY CO.	PHILADELPHIA, PA	80/84	C	N/A	125	ANIMAL OILS & CHEMS	CHEMICAL	NO
8-398	ALCO CHEMICAL	PHILADELPHIA, PA	3/80	C	N/A	12	SURFACTANTS	CHEMICAL	W.VA
8-398	BP OIL	PHILADELPHIA, PA	1/83	C	7	3	RECLAMATION SHOP	ENERGY	NO
8-398	CENTURY INKS	PENNSAUKEN, NJ	3/82	C	4	7	PRINTING INKS	CHEMICAL	ONTARIO, CANADA
8-398	STEPAN-ARMAK-KEESLER	PHILADELPHIA, PA	12/82	C	16	23	PLASTICIZERS	CHEMICAL	N/A
8-406	AIR PRODUCTS CO.	BOUND BROOK, NJ	4/82	C	4	32	PLASTICS & RESINS	CHEMICAL	NO
8-406	C.B. CRYSTAL	JERSEY CITY, NJ	5/81	C	9	5	CHEM WAREHOUSE	CHEMICAL	NO
8-406	LEHMAN BROS.	JERSEY CITY, NJ	12/82	C	9	60	PAINTS	CHEMICAL	BOSTON, MA
8-406	ROYCE CHEMICAL	E. RUTHERFORD, NJ	2/82	C	4	115	ZINC OXIDE	CHEMICAL	PORTSMOUTH, VA
8-417	REACTOR LABORATORIES	PATERSON, NJ	8/81	C	0	9	DYESTUFFS	CHEMICAL	NO
8-438	SQUIBB CO.	NEW BRUNSWICK, NJ	2/82	P	5	296	PENICILLIN	CHEMICAL	NO
8-455	PENNZOIL	ROUSEVILLE, PA	4/83	C	9	12	PRINTSHOP	ENERGY	LOS ANGELES, CA
8-472	GETTY OIL	NEW HAVEN, CT & PROVIDENCE, RI	1/85	C	N/A	50	OIL PROD. TERM	ENERGY	NO
8-472	TEXACO	NEW HAVEN, CT	12/82	P	9	8	PETRO.PROD.TERM.	ENERGY	NO
8-477	C.H. STUART	NEWARK, NY	6/82	C	4	350	CONTRACT PACKAGING	MISC.	NO
8-481	QUAKER STATE	EMLENTON, PA	10/80	P	14	96	OIL REFINING	ENERGY	NO
8-548	UNION CARBIDE	ESSINGTON, PA	3/83	C	104	53	INDUSTRIAL GASES	CHEMICAL	HATFIELD, PA*
8-562	PARTICLE SIZE TECH.	LAKEHURST, NJ	6/81	C	N/A	24	CHEMICAL GRINDING	CHEMICAL	NO
8-580	CORENCO CORP.	NESCOPECK, PA	5/81	C	0	15	RENDERING PLANT	MISC.	NO
8-584	SAPOLIN PAINTS	BROOKLYN, NY	7/80	P	N/A	100	PAINTS	CHEMICAL	NO
8-600	UNION CARBIDE	KITTANING, PA	10/82	C	8	77	AIR SEPARATION	CHEMICAL	NO
8-616	ALLIED CHEMICAL	BUFFALO, NY	8/82	C	9	53	POLYETHYLENE RESINS	CHEMICAL	ORANGE, TX
8-619	STAUFFER CHEMICAL	SKANEATELES FALLS,NY	8/81	P	22	38	DETERGENT CHEMS	CHEMICAL	NO
8-623	TEXACO	BAYONNE, NJ	1 & 5/85	C	N/A	171	OIL PROD. TERMINAL	ENERGY	NO
8-638	TEXACO	WESTVILLE, NJ	2/83	P	7	140	PETRO. REFINING	ENERGY	NO
8-673	AMER. COLOR & CHEM.	LOCK HAVEN, PA	6/83	C	52	230	DYESTUFFS	CHEMICAL	
8-729	BAKER CHEMICAL	PHILLIPSBURG, NJ	7/81	P	6	256	CHEMICALS PKG	CHEMICAL	JACKSON,TN BARBVL,KY
8-729	PURITY ZINC METALS	EASTON, PA	3/83	C	0	10	ZINC SMELTER	MISC.	NO
8-732	AMOCO CHEMICAL	NEW CASTLE, DE	4/81	C	14	175	POLYPROPYLENE	CHEMICAL	NO
8-775	NL INDUSTRIES	SEE 8-3660		C				CHEMICAL	
8-784	UNION CARBIDE	WAYNE, NJ	7/80	C	14	290	PLASTIC BAGS	CHEMICAL	E. HARTFORD, CT
8-787	BERKELEY CHEM. GULF	BERKELEY HTS, NJ	10/81	C	9	51	MISC. CHEMICALS	CHEMICAL	NO
8-791	MT CO.	WESTERN PA	7/83	C	26	6	CRUDE OIL TRANSPRT	ENERGY	NO

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LOCAL	COMPANY	LOCATION	DATE SHUTDOWN	COMPLETE OR PARTIAL	WEEKS OF NOTICE	JOBS LOST AT CLOSE AND 2 YEARS PRIOR	PRODUCT LINE	PRODUCT CATEGORY	RUNAWAY PLANT
8-830	NL INDUSTRIES	SEE 8-3660		C				CHEMICAL	
8-637	KAWECKI BERYLCO	HAZLETON, PA	8/81	C	23	175	BERYLLIUM COMPOUNDS	CHEMICAL	NO
8-901	SUN OIL	MARCUS HOOK, PA	2/84	C	N/A	250	LUBE BUSINESS	ENERGY	NO
8-3660	NL INDUSTRIES	SAYREVILLE, NJ	82/83	C	1	475	PIGMENTS	CHEMICAL	CANADA, EUROPE
8-6220	MOBIL OIL	BUFFALO, NY	8/81	P	19	153	OIL REFINING	ENERGY	NO
8-12058	CARBORUNDUM	NIAGARA FALLS, NY	5/83	P	9	350	GRINDING WHEELS	MISC.	NO
8-20581	H. & R. JOHNSON	KEYPORT, NJ	9/81	P	N/A	105	CERAMIC TILES	MISC.	CANADA
# GROUPS 59						5,430			

TOTAL # GROUPS
203

TOTAL P'S
41

TOTAL C'S
162

TOTAL JOBS LOST
22,159

TOTAL JOBS-ENERGY
9,017

TOTAL JOBS-CHEM.
9,193

TOTAL JOBS-MISC.
3,949

* OCAW ORGANIZED PLANTS

**THERE IS SOME CHANCE THAT THIS PLANT MAY REOPEN AT SOME TIME IN THE FUTURE.

NOTE - ABOVE INCLUDES BUT DOES NOT ACCOUNT SEPARATELY FOR OCAW MEMBERS LAID OFF AND TRANSFERRED TO OTHER COMPANY LOCATIONS. ALSO INCLUDES NON-MEMBERS IN BARGAINING UNIT.

Mr. **Florio**. Thank you very much. I appreciate the testimony of all of our witnesses. Let me ask Mr. Houghton particularly, can you tell us your recent experience with the ITC in the optical wave guide fibers situation, and would this bill have made any difference. If this bill had been the law, would there have been any opportunity to change that experience?

Mr. **Houghton**. Mr. Chairman, I could talk about this in general terms. I think the real expert in this, as far as the company and the person who's been involved in this thing is Dr. Duke. Would it be possible——

Mr. **Florio**. Certainly.

Mr. **Duke**. Yes, Mr. Chairman. Our experience in the recent ITC is that after the trial, the administrative law judge and then the ITC Commission ruled with one dissenting opinion, that although our patents were found valid and infringed, there was not enough proof of injury or potential injury to this market and to this industry, and therefore, there was no injunction to stop importation coming in from Japan.

I am convinced that if this legislation of targeting had been introduced, this would have made—it would have given us an alternative route to address the targeting issue, because there's no question there has been targeting, the patents were valid and infringed. But as I pointed out I think in my earlier testimony, apparently you have to wait until the patient is terminally ill before you can get any remedy under the present laws.

Mr. **Florio**. With regard to fiber optics, realizing these are very imprecise numbers, can you give us some sense of proportion as to the difficulties that the industry is running into, concerning targeting practices, unfair labor practices versus the over-valued dollar? Can you give us some sense of what the responsibility is for the industry's difficulty between those two general categories?

Mr. **Houghton**. Let me just give you one example that to me sort of sums up what we're fighting here. We sell—and I think this is accurate—a cabled meter of fiber optics, the most modern, it's called single mode, fiber optics for about 70 cents, really throughout the free world. In Japan, that same cabled meter made in Japan and sold in Japan sells for about $2.50. And we haven't sold one single strand.

And yet they can go in, having closed their home markets to Third World countries, the third market countries, into ours and charge anything they want.

Mr. **Florio**. So the response then is that certainly, the over-valued dollar is not responsible for the price differential.

Mr. **Houghton**. It has nothing to do with it.

Mr. **Florio**. Let me ask perhaps Mr. Millian on the question—and you made reference to Mexico before—natural gases below market prices. There have been legislative proposals that have been floated out, and yet my understanding is that the business community is divided, particularly the petroleum industry is divided on this question. Can you give us some explanation as to why we find divisions within the business industry?

Mr. **Millian**. Well, I think yes, Mr. Chairman, there's the natural division between the importers of a product that is made abroad—for example, in the Soviet Union. One of our major competitors, has a counter trade arrangement with the Soviet Union and brings in ammonia at a competitive price.

Another example would be certain oil interests that deal with the Government of Mexico, for example, to draw down certain petroleum—bringing into the United States. Obviously, they're going to be in opposition to us because politically, they have to be on a different side.

I think there's been, what we call in our group, specters rather than ghosts—ghosts don't go away but specters can be removed with knowledge—involving the Saudis. For example, there are certain representatives of major petroleum companies who feel that the legislation last year, which we have introduced a gain in the LICIT and Gibbons bills, could do damage to the Saudi relationship that they have.

We argue first of all, that natural gas cannot be exported in its real form without a great cost, from Saudi Arabia, and that therefore that's not part of the argument for us. We also note that there is access to that natural gas through joint ventures, which some companies are involving themselves in.

In the Mexican case, if we could go down and take natural gas at 40 cents, which they were selling to themselves by an intercompany transfer, and bring it up to our ammonia plants, we would have no gripe.

I think all three of the bills have four basic aspects that some people just don't understand. One, that it has to be a Government-owned entity before natural resource subsidy provision begins to take effect. Second, that the product is not available to U.S. producers, that is they are not able to go down and take the natural gas. Third, that natural resource input into the final product that comes into the United States is significant. Fourth, they do export the natural gas at one price, a higher price, and sell it internally at a lower price to themselves. Therefore, the so-called two-tier pricing.

Mr. FLORIO. Why the particular emphasis on Government owned as opposed to Government regulated? Isn't it quite conceivable that you could be talking about someone getting out from under the prescription of the bill if it were enacted into law by saying that, fine, we transfer ownership to someone, and we are just going to say that the price is going to be kept artificially low?

I suspect there has probably been criticism of our Nation in the past for regulations in that regard.

Mr. MILLIAN. That's right, and I think the language of the actual bill does not say Government controlled or by quasigovernment organizations, but rather where the Government is the predominant controlling factor.

Mr. FLORIO. The president of Texaco was quoted last Sunday in the paper as saying that the future of the refinery business—and perhaps I would ask this of both our petrochemical, petroleum representatives here today—that the future of the refinery business in the United States depends on Government intervening to restrict imports of refined petroleum products.

I'm wondering if this is the view of the business community, if this is developing as the view of the business community in this petrochemical and petroleum products industry.

Mr. **Misbrener.** Mr. Chairman, I don't believe that that view expressed by Mr. McKinley is shared by all of his counterparts in the petroleum industry. I think just recently I read a statement by the Mobil Oil Corp., which espoused the continued adoption of the free trade concept. Of course, what we see here is a multinational corporation, and this is true of both Texaco and Mobil, where they both have large overseas holdings and can import into the United States with perhaps some of the same advantages that the Saudis will in the very near future when they come onstream with their refinery.

The specific answer to your question is no, I don't think that that view expressed by Mr. McKinley is shared by everyone. I think we will see shortly—at least I hope so—that opinion shared by others.

Mr. **Florio.** I'm not sure I fully understand the rationale for Texaco or a multinational corporation to be advocating that type of action which it appeared he was advocating.

Mr. **Misbrener.** I don't want to be the spokesman for Texaco.

Mr. **Florio.** Let's talk more generically. I mean we are talking about people with overseas capacity, multinational petroleum companies.

Mr. **Misbrener.** I could only surmise that their principal concern or would hope that their principal concern is the status of their operation in the United States as the linchpin of their total operation worldwide, and where that would appear to be in danger, that they would want to protect that interest.

Mr. **Florio.** Who would be opposed to that sort of an approach? Are there independent producers who would be hurt as a result of import restrictions on imported gasoline? I know your constituents are. My constituents are. We have a refinery, the Arco refinery in Philadelphia, that is closing, and I have talked to the workers there and they have told me that in part, imported gasoline is competitive—as a matter of fact, better priced—is part of the problem there.

The refinery, the old Texaco refinery at Eagle Point in my district, likewise the workers there have talked about the inability to compete with imported gasoline. The refined product is landing here at price below that it is able to be refined in the facilities there.

But I'm not sure I understand who the business actors would be who would be benefited by no restrictions on imported gasoline. Are there types of petroleum producers overseas, independents? Do you have any sense of who benefits from that, from no limitations on import restrictions?

Mr. **Misbrener.** First of all, I think, Mr. Chairman, you will find that the Independent Refiners Coalition is vitally interested in some kind of a restriction on imports of refined products.

As to those who would benefit from it, it would seem to me—and this is purely a guess because I don't know the total economics of their operation—it would seem to me that certainly OPEC, as an example, the OPEC nations, with their own refinery capacity and their ability to export refined products as well as to have some determination made in the price of the crude oil and then how much they want to charge themselves for that crude oil when they refine it into refined products, and then the ability then, of course, to sell the refined products abroad at a cheaper price than those refiners here in the United States, would certainly favor the continued ability to put it on the American market at a cheaper price.

Mr. **Florio**. Is that a comparable situation to the ammonia example you are talking about?

Mr. **Misbrener**. I think so, Mr. Chairman, exactly. It is a rather new phenomenon for us in the petroleum industry. Let me just quote from my written text. Most foreign refiners, according to Platt's Oilgram, which is considered to be somewhat of an expert on the petroleum industry, that most foreign refiners could not have sold gasoline at a profit in the U.S. market over the period based on posted prices—over any period based on posted market prices of crude oil.

How do they compete with the most sophisticated gasoline refining industry in the world? They do it by discounting the price of the crude oil that is refined in their own refinery. It can't be done in any other way.

Meanwhile, they export the same crude oil to U.S. refiners at higher market prices. Foreign Government controlled and assisted refiners obviously are using discriminatory subsidies to penetrate our markets.

Mr. **Millian**. If I might comment on the ammonia side of your question. In my prepared testimony I included a letter which I wrote to Under Secretary of Commerce Wethington on this subject in which I quoted a translation of the Mexican Industrial Development Plan. It specifically states that there are Government-owned entities or supported entities abroad who look at business second and the dollar-gaining possibility first, or at developing an internal industry by using the export market.

For example—and I'm quoting from the Mexican plan:

> This plan is complemented by an explicit policy of maintaining internal prices of energy sources for industrial use below that of the international market. This allows for the strengthening of industry by giving it a substantial margin of protection via inputs. In contrast to other forms of protection which tend to make such costs more expensive and access to external markets more difficult, this mechanism constitutes a direct incentive to exports.

Now, that is a different reason for coming into the marketplace, and that is what we are saying, that we can't compete against that type of different reason.

Mr. **Florio**. Yes, sir.

Mr. **Hancock**. Mr. Florio, as we represent the energy industry in this country, we also represent a number of other industries in this country. We represent the titanium industry. We represent workers who produce products from corn milling and soybean milling and so forth. We are seeing the same thing happen across the spectrum of the companies that we represent.

We are seeing restrictions on the corn, France trying to restrict our exports to them of corn gluten feed. At the same time, France provides great subsistence to farmers and to the agriculture industry in France.

We exported our titanium technology to Japan. Now Japan has come back and captured more than half of our titanium market in this country. The same thing is happening in the uranium industry. Before 1979 we had 100 percent use of U.S. uranium. Now almost all of the contracts for uranium, almost all of them, Mr. Chairman, are from foreign sources.

In the oil industry we are seeing a situation where we are now becoming dependent upon the foreign governments for refined products. We had, as you remember, back in the 1973 and the 1979 area, we had the problems with imported crude, and now we are reaching a situation where we are not going to be able to refine the amount of crude necessary for the daily use in this country.

So clear across the spectrum of the groups we represent, we are being outmaneuvered by foreign trade. They have targeted our markets, they have captured our markets, and we are seeing, as our president has indicated, we are seeing a substantial loss in jobs of those that we represent.

So the importance of the bill that we are talking about today is it is going to level that playing field in many areas so that we can be competitive in the marketplace. Our members could work for zero wages in the oil refineries and in the petrochemical plants and yet we couldn't compete at the marketplace.

It is not a problem of wages; it is a problem of subsidized foreign imports.

Mr. FLORIO. Let me express my appreciation to the panel.

I have been informed that we have to vacate the room by 1:30, so out of courtesy to our last panel of witnesses, we are going to finish with this panel.

I do appreciate your participation and your very helpful comments. Thank you very much.

Our last two witnesses I would like to come forward now, Mr. James T. Asher, vice president, administration, Harris Corp., semiconductor sector, on behalf of the Semiconductor Industry Association, and Dr. John Makin, director of fiscal policy studies of the American Enterprise Institute.

Gentlemen, we welcome you to our committee. Your statements will be made a part of the record. You may feel free to proceed as you see fit.

Mr. Asher, I would like you to introduce your colleague, and we will be happy to hear from you.

STATEMENTS OF JAMES T. ASHER ON BEHALF OF SEMICONDUCTOR INDUSTRY ASSOCIATION; AND JOHN H. MAKIN, DIRECTOR OF FISCAL POLICY STUDIES, AMERICAN ENTERPRISE INSTITUTE

Mr. ASHER. I am joined at the table by Michael Gadbaw and Tim Richards of the firm of Dewey, Ballantine, Bushby, Palmer & Wood, who represent the Semiconductor Industry Association.

Further, I will try to summarize my comments and have my full written testimony placed into the record, and for your perusal or analysis at a later time, we will also leave the full 301 petition which we are here to discuss.

Mr. Chairman, my name is James T. Asher. I am vice president of administration for Harris Corp., semiconductor sector, and I appear before you today on behalf of the Semiconductor Industry Association [SIA].

SIA is an association of 52 members which together manufacture more than 95 percent of all semiconductors produced in the United States each year. One of SIA's principal purposes since its foundation in 1977 has been to address issues concerning international trade in semiconductors.

First and foremost among these trade issues has been the restrictive nature of the Japanese semiconductor market. Over the 8-year period since 1977, SIA has worked with the U.S. Government to seek greater access to the Japanese semiconductor market.

SIA's member companies have also taken steps to make the sale of semiconductors in the Japanese market one of their top priorities. Yet despite all of these efforts, the U.S. share of the Japanese semiconductor market remains about the same today, approximately 10 to 11 percent, as it was in 1975 when formal quotas prevented U.S. semiconductor companies from selling their products in Japan.

As you can see from this chart in front of you, the stable 10 percent no increase in penetration has continued right through 1984, with the exception of a slight increase during a period of short supply in 1979 and again in 1984.

The Government-imposed and condoned barriers to trade which exist in Japan have caused serious injury to U.S. companies. Because less formal governmental and private efforts to resolve the problem have proven inadequate, SIA has taken the one step open to us under U.S. law to obtain relief from these foreign government practices.

On Friday, June 14, we filed a petition with the Office of the United States Trade Representative under section 301 of the Trade and Tariff Act of 1974 as amended. By initiating a formal 301 case, the United States and Japanese Government's efforts can be focused on what are the essential problems in semiconductor trade with a clear timetable for obtaining remedial action.

It gives me great pleasure, Mr. Chairman, to appear before your committee today to discuss our case. Before I proceed with a description of the SIA case, I would like to stress the importance of the amendments made to the Trade Act of 1974 by the Congress last year in the Trade and Tariff Act of 1984.

These amendments, particularly the addition to section 301 of language which enables the President to take action against foreign government policies which deny fair and equitable market opportunities to U.S. companies, played a critical role in the SIA decision to file this case.

I wish to thank you, Mr. Chairman, and this committee for your active role in bringing about the changes to section 301 which were made last year.

We hope that our case, which is the first to be brought under the amended law, will prove the value of section 301 as an effective element of U.S. trade law and will demonstrate the benefits which can be gained by periodic revision of the trade laws.

In our petition we seek two things: a share of the Japanese semiconductor market which at a minimum is equal to the share Japanese semiconductor companies hold in the U.S. market, and a commitment from the United States and Japanese Government to take steps to forestall the dumping of semiconductors in the United States.

We in the United States have taken every possible step to achieve a greater participation in the Japanese market. We have increased the corporate resources devoted to our sales efforts in that market. We have built production, warehousing, and design facilities in Japan, and we have included a brief description of companies' commitments to our testimony.

During periods of worldwide semiconductor shortages, particularly the most recent one, we increased the portion of our product allocated to our Japanese customers, and, I might add, sometimes at the expense of our domestic customers, in an attempt to prove our commitment to that market.

The U.S. Government has also been extremely helpful in working to break down Japanese barriers to semiconductor market access.

When the Japanese semiconductor market was protected by quotas and tariffs, the U.S. Government negotiated their elimination. When Japanese semiconductor companies began to engage in predatory pricing practices during the 1982 semiconductor recession, the U.S. Government began serious negotiations with the Government of Japan to resolve high technology trading problems through the U.S.-Japan High Technology Working Group.

These negotiations, which I had the pleasure of serving on as an industry adviser resulted in the adoption by both governments of the High Technology Agreement and the Semiconductor Recommendations. Those recommendations, had they been carried out by the Japanese Government certainly laid the groundwork for an improved system of international trade in semiconductors between our two nations.

Yet we are now faced with the reality that all of these efforts have clearly failed. We faced the same problems in Japan that have existed for over a decade. Although U.S. semiconductor companies enjoy a 55-percent share of the world semiconductor market, including a majority of the European market and 46 percent of the rest of the world market, our share in Japan has remained at only about 10 percent, despite all efforts, including tariff cuts, the elimination of quotas, and major currency realignments.

Mr. **Florio**. Could you—why, I mean, if you arrived at the conclusion—I'm sorry. Why don't you go forward with your testimony, and I'll ask you when you finish.

Mr. **Asher**. Yes, sir.

Moreover, Japanese companies may be again using their protected home market to penetrate the U.S. market, selling their products at prices that violate the U.S. antidumping law.

Hitachi, beginning in early February and running through early June, utilized a pricing policy under which Hitachi distributors were instructed to sell a certain type of semiconductor product at 10 percent below U.S. competitors' prices, whatever price the U.S. competitor quotes, with no mention at all of costs.

Mr. Chairman, having spent 25 years in this business, Hitachi recently repudiated that as not representing formal company policy, but in today's marketplace, any product line manager in this business knows almost on a daily basis and directs on a daily basis the pricing practices that are taking place in the market, let alone having a situation where he was not aware of a particular pricing practice for a 3-month period.

At a time when the semiconductor industry worldwide is going through its most serious recession ever, with plant closings, layoffs, and financial losses occurring throughout the industry in this country, this sort of pricing practice compounds the injury to U.S. semiconductor companies.

At the same time, the commitments made by the Japanese Government to eliminate trade barriers have been frustrated by Government-imposed and supported countermeasures, which have essentially substituted structural market barriers for the formal Government barriers such as quotas and tariffs.

SIA hopes the filing of our 301 case will permit both the United States and Japan to make the resolution of these problems a top-priority international trade issue.

Through bilateral negotiations we hope to achieve the same opportunities to sell in Japan that Japanese companies enjoy in the U.S. market. Their sales have risen from 7 percent of the market in 1980 to nearly 20 percent by the fourth quarter of 1984.

World trade in semiconductors is on the rise in all major regions of the world, and the U.S. industry is participating in that growth, except in Japan. U.S. companies clearly play a residual role in Japan. During the period of greatest semiconductor demand and shortest supply in early 1984, U.S. companies' sales in Japan rose far faster than the growth of the Japanese semiconductor market. This continued to the third quarter of last year.

As you can see in this chart, particularly in that quarter that we're talking about, the United States sales increased at a rate approximately double that of the Japanese market, and that was at a time when capacity could not keep up with demand, and then we have subsequently, as you can see as you move into the last quarter, have fallen into a residual status again, with our sales falling off at double the rate that the market has turned down.

As I have described, the U.S. companies were willing to divert scarce semiconductor products from other markets because they had committed themselves as part of the High Technology Working Group's Semiconductor Recommendations to support the Japanese market. Because Japanese companies were unable to supply all the product they required, Japanese purchasers of semiconductors turned to the U.S. companies during this period.

As soon as the semiconductor boom began to subside, however, U.S. companies were the first companies operating in Japan to feel the effects of the slowdown. Although the Japanese market continued to grow in the fourth quarter of 1984, Japanese companies by then were able to fill all increases in domestic demand, and sales by U.S. companies actually declined.

The residual role of the U.S. companies was even more dramatically illustrated by the fact that between the fourth quarter of 1984 and the first quarter of this year, the Japanese semiconductor market softened very seriously, and U.S. companies suffered a decline in sales twice as great as the decline of the Japanese market as a whole.

The efforts of our companies during the previous period of supply shortage and the agreements entered into by the Government of

Japan apparently and obviously had no effect on our role as residual suppliers.

In the interest of time, Mr. Chairman, I will not go through the specifics of the petition, but I will be certainly pleased to answer any questions you have relative to the basis of the petition.

With this environment, SIA believes only concentrated effort by the Government of Japan to eliminate those features of its market which it intentionally established to frustrate trade liberalization will permit U.S. companies to participate in the Japanese semiconductor market to the full extent indicated by our competitiveness in the rest of the world.

In conjunction with these essential changes in the structure of the Japanese market which are required, we will seek commitments first from the Government of Japan to encourage Japanese semiconductor companies to abide by international trading rules dealing with dumping, and second, from the U.S. Government to take prompt and effective action to enforce U.S. trade laws against actual and threatened dumping.

Now that our petition has been filed and, we hope, formally initiated as soon as possible within the next 2 weeks, SIA intends to provide to the U.S. Government whatever support is required to open the Japanese semiconductor market to full foreign participation.

SIA remains committed to the principles of free and fair trade. We do not wish to see any restrictions imposed which would deny U.S. consuming industries adequate volumes of semiconductors which meet their selection criteria. What we seek is to have Japan assume its full responsibilities as a trading partner with the United States.

Semiconductors are an area in which U.S. producers are clearly competitive and in which we have been denied access to the Japanese market, the second largest market in the world. Only by providing U.S. semiconductor companies with full access to the Japanese market will Japan finally have put in place a trading environment which will reflect the competitive balance between the industries or our two nations, instead of an out-of-date model of a weak, impotent Japanese semiconductor industry in need of protection.

One point—and I know there's been some discussion on this this morning—the situation with regard to correcting the sales of U.S. semiconductor products in Japan, as opposed to a consumer type product, does not require a basic cultural change of millions of people, as it would with a consumer product. The six largest electronics companies in Japan, who also happen to be semiconductor producers, represent about 70 to 80 percent of the Japanese market. So the commitment to treat U.S. producers fairly in an open market environment and purchase U.S. semiconductors on an equal basis can be implemented by six companies, not necessarily by a whole nation.

I would like to commend this committee for its continued examination of U.S. trade laws. As the SIA experience has shown, the Congress brought about significant improvements to section 301 last year, for which SIA is deeply appreciative.

At the same time, there are certainly additional areas in which these laws will have to be modified, as international trade increases in areas such as high technology products and services in which the economics of trade may differ from traditional models.

Moreover, as national governments develop new and more subtle forms of protectionism in support for their domestic industries, U.S. trade law must keep step with these changes.

Thank you very much, Mr. Chairman, for the opportunity to testify before your committee on this subject, which is obvious interest to SIA and my company.

Mr. FLORIO. Thank you very much.

[Testimony resumes on p. 257.]

[The prepared statement of Mr. Asher follows:]

Testimony of
James T. Asher

Mr. Chairman, my name is James T. Asher. I am Vice President for Administration of Harris Corporation, Semiconductor Sector, and I appear before you today on behalf of the Semiconductor Industry Association (SIA). SIA is an association of fifty-two members which together manufacture more than ninety-five percent of all semiconductors produced in the United States each year.

One of SIA's principal purposes since its foundation in 1977 has been to address issues concerning international trade in semiconductors. Foremost among these trade issues has been the restricted nature of the Japanese semiconductor market. Over the eight years since 1977, SIA has worked with the U.S. Government to seek greater access to the Japanese semiconductor market. SIA's member companies have also taken steps to make the sale of semiconductors in the Japanese market one of their top priorities. Yet, despite all of these efforts, the U.S. share of the Japanese semiconductor market remains about the same today -- at 10-11 percent -- as it was in 1975 when formal quotas prevented U.S. semiconductor companies from selling their products in Japan.

The Government-imposed and condoned barriers to trade which exist in Japan have caused serious injury to U.S. companies. Because less formal governmental and private efforts to resolve the problem have proven inadequate, SIA has taken the one step open to us under U.S. law to obtain relief from these foreign government practices. On

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The SIA Case

In our petition, we seek two things: a share of the Japanese semiconductor market which, at a minimum, is equal to the share Japanese semiconductor companies hold in the United States market, and a commitment from the U.S. and Japanese Governments to take steps to forestall the dumping of semiconductors in the United States.

We in the United States have taken every possible step to achieve a greater participation in the Japanese market. We have increased the corporate resources devoted to our sales efforts in that market. We have built production, warehousing and design facilities in Japan to support our sales there (See Appendix A). During periods of worldwide semiconductor shortages, we have increased the portion of our product allocated to our Japanese customers.

The United States Government has also been extremely helpful in working to break down Japanese barriers to semiconductor market access. When the Japanese semiconductor market was protected by quotas and tariffs, the U.S. Government negotiated their elimination. When Japanese semiconductor companies began to engage in predatory pricing practices during the 1982 semiconductor recession, the U.S. Government began serious negotiations with the Government of Japan to resolve high technology trading problems through the U.S.-Japan High Technology Working Group. These negotiations resulted in the adoption by both Governments of the High Technology Agreement and the Semiconductor Recommendations which together laid the groundwork for an improved system of international trade in semiconductors between our two nations.

Yet we are now faced with the reality that all of these efforts have clearly failed. We face the same problems in Japan that have existed for over a decade. Although U.S. semiconductor companies enjoy a 55% share of the world semiconductor market including a majority of the European market and 46% of the market in the rest of the world, our share in Japan has remained at only about 10% despite our greatly increased marketing efforts, tariff cuts, the elimination of quotas, and major currency realignments.

Moreover, Japanese companies may be again using their protected home market to penetrate the U.S. market, selling their products at prices that violate the U.S. antidumping law. Hitachi has only recently ceased to utilize a pricing policy under which Hitachi distributors were instructed to sell a certain type of semiconductor product at 10 percent below the U.S. competitors' price, whatever price the competitor quotes -- with no mention at all of costs. In return, the Hitachi distributors were guaranteed a 25% profit. At a time when the semiconductor industry worldwide is going through its most serious recession ever, with plant closings, layoffs, and financial losses occurring throughout the industry in this country, this sort of pricing practice compounds the injury to U.S. semiconductor companies.

At the same time, the commitments made by the Japanese Government to eliminate trade barriers have been frustrated by government-imposed and supported "counter-measures" which have essentially substituted structural market barriers for the formal government barriers such as quotas and tariffs. SIA hopes the filing of our 301 case will permit both the United States and Japan to make the resolution of these problems a top priority international trade issue.

Through bilateral negotiations, we hope to achieve the same opportunities to sell in Japan that Japanese companies enjoy in this market (where their sales have risen from 7% of the market in 1980 to nearly 20% of the market by the fourth quarter of 1984). World trade in semiconductors is on the rise -- in all major regions of the world, that is, except Japan. We would like to eliminate those features of the Japanese semiconductor market that were intentionally established to frustrate trade liberalization and which have restricted U.S. companies to the role of residual suppliers in the Japanese semiconductor market.

U.S. companies clearly play a residual role in Japan. During the period of greatest semiconductor demand and shortest supply in early 1984, U.S. companies' sales in Japan rose far faster than the growth of the Japanese semiconductor market as a whole. This continued through the third quarter of last year. As I have described, U.S. companies were willing to divert scarce semiconductor products from other markets because they had committed themselves as part of the High Technology Working Group's Semiconductor Recommendations to support the Japanese market. Because Japanese companies were unable to supply all the product they required, Japanese purchasers of semiconductors turned to these U.S. companies during this period.

As soon as the semiconductor boom began to subside, however, U.S. companies were the first companies operating in Japan to feel the effects of the slow-down. Although the Japanese market continued to grow in the fourth quarter of 1984, Japanese companies were by then able to fill all increases in domestic demand, and sales by U.S. companies actually declined. The residual role of the U.S. companies was even more dramatically illustrated by the fact that between the fourth quarter of 1984 and the first quarter of this year the Japanese semiconductor market softened very seriously and U.S. companies suffered a decline in sales twice as great as the decline of the Japanese market as a whole. The efforts of our companies during the previous period of supply shortage and the agreements entered into by the Government of Japan had no effect on our role as residual suppliers.

What are the characteristics of the Japanese semiconductor market which leave foreign suppliers in this position? They are described in detail in our memorandum in support of our petition, but let me provide a brief overview of them.

First, the Government of Japan has protected every semiconductor end-market industry until it achieved a clear market parity with foreign producers. Because of this, Japanese companies dominate most major semiconductor end markets in Japan.

Second, the Government of Japan limited entry into the semiconductor industry to a few established end-users of semiconductors. This was accomplished through subsidies and joint research and development assistance. The result is that the same six to ten firms which are dominant in the end-use markets are also the major Japanese semiconductor manufacturers.

Third, the Japanese Government encouraged these firms to develop reciprocal interfirm trading relationships so that they would procure semiconductors primarily from each other. As a result, about two thirds of the semiconductors consumed in Japan are purchased by one of the major electronics companies from another of these major electronic companies.

Fourth, the small group of semiconductor producer-consumers are linked by multiple horizontal ties. These ties too were fostered by the Government of Japan through numerous R&D programs from which second-rank producers (and foreign companies) have been excluded. One of the purposes of these links has been to avoid the so-called "excessive" competition and duplication of effort among Japanese firms. In the United States, such horizontal ties among dominant firms would be seen as giving rise to a substantial danger of collusive and anticompetitive behavior.

Finally, the Japanese Government encouraged Japanese semiconductor purchasers to "Buy Japanese". This pressure was continued until at least 1974. Since then, U.S. semiconductor executives have been virtually unanimous in their view that a bias persists in Japan.

The entire market access situation created by these measures is perhaps best summarized by an executive in charge of one U.S. company's Japanese operations. In response to an SIA survey of U.S. companies' experiences in Japan, he said: "Basically a U.S. supplier has an opportunity when a product is not available from a Japanese source or is in short supply."

In this environment, SIA believes only concentrated effort by the Government of Japan to eliminate those features of its market which it intentionally established to frustrate trade liberalization will permit U.S. companies to participate in the Japanese semiconductor market to the full extent indicated by our competitiveness in other world markets. In conjunction with those essential changes in the structure of the Japanese semiconductor market, we will seek commitments first from the Government of Japan to encourage Japanese semiconductor companies to abide by international trading rules dealing with dumping and second from the U.S. Government to take prompt and effective action to enforce U.S. trade laws against actual and threatened dumping.

Conclusion

Now that our petition has been filed, and we hope formally initiated as soon as possible within the next two weeks, SIA intends to provide to the U.S. Government whatever support is required to open the Japanese semiconductor market to full foreign participation. We hope a negotiated solution to the issues we have raised will be reached in a timely manner. We do not wish to reach a situation in which a resolution can only be achieved by unilateral actions of the U.S. Government such as those we have proposed in our petition. The only satisfactory long term solution is market access, pure and simple.

SIA remains committed to the principles of free and fair trade. We do not wish to see any restrictions imposed which would deny U.S. consuming industries adequate volumes of semiconductors which meet their selection criteria. What we seek is to have Japan assume its full responsibilities as a trading partner with the United States. Semiconductors are an area in which U.S. producers are clearly competitive and in which we have been denied access to the Japanese market -- the second largest market in the world. Only by providing U.S. semiconductor companies with full access to the Japanese market will Japan finally have put in place a trading environment which will reflect the competitive balance between the industries of our two nations instead of an out-of-date model of a weak infant Japanese semiconductor industry in need of protection

I would like to commend this Committee for its continued examination of U.S. trade laws. As the SIA experience has shown, the Congress brought about significant improvements to Section 301 last year, for which SIA is deeply appreciative. At the same time, there are certainly additional areas in which these laws will have to be modified as international trade increases in areas -- such as high technology products and services -- in which the economics of trade may differ from traditional models. Moreover, as national governments develop new, and more subtle, forms of protectionism and support for their domestic industries, U.S. trade law must keep step with those changes.

Thank you very much Mr. Chairman for the opportunity to testify before your committee on this subject of obvious interest to SIA and to my company.

APPENDIX A

U.S. SEMICONDUCTOR COMPANIES HAVE MADE MAJOR EFFORTS TO ACHIEVE A GREATER SHARE OF THE JAPANESE SEMICONDUCTOR MARKET

Advanced Micro Devices --

Sales subsidiary (1974). Engineering design-in capability. Distribution through Japanese distributors. Inventory available in Japan.

American Microsystems Inc. --

Joint venture (1982). Engineering design center for semi-custom products. Direct sales and sales representatives.

Fairchild Camera and Instrument Corporation --

Subsidiary (1972). Manufacturing of semiconductors in Japan. Engineering design capability. Distribution through Japanese distributors and direct sales. Inventory available in Japan.

Harris Corporation --

Sales subsidiary (1974). KK subsidiary (1984). Test operation (1985). Distribution through Japanese distributors and direct sales force. Inventory available in Japan.

Intel Corporation --

Wholly owned subsidiary (1981). Sales, testing and design center. Corporate procurement center. Inventory available in Japan. Distribution through Japanese distributors and direct sales force.

Monolithic Memories, Inc. --

Subsidiary (1975). Testing, programming, marking and shipping conducted in Japan. Inventory available in Japan. Direct sales force and Japanese distributors.

Motorola, Inc. --

Sales subsidiary (1962). 1980 acquired 50% interest in semiconductor manufacturing company. 1982 purchased 100% of semiconductor manufacturing company. Head office Tokyo. Sales through direct sales force and eight Japanese distributors. Inventory available in Japan.

National Semiconductor Corporation --

Sales subsidiary (1973). Engineering design-in capability. Forty percent of total employees in Japan are engineers. Testing facilities for logic and linear chips. Sales through direct sales force and Japanese distributors. Inventory available in Japan.

Signetics Corporation --

Sales subsidiary (1975). Value-added center. Test floor. Application group. Sales offices in Tokyo and Osaka. Distribution by direct sales force and by Japanese distributors. Inventory available in Japan. All employees Japanese nationals or fluent in Japanese.

Texas Instruments, Inc. --

Joint venture for manufacture (1968). Wholly owned subsidiary for manufacture (1971). Two additional semiconductor manufacturing operations since 1971. Plants now located in Hatogaya, Hiji, and Miho. Distribution by direct sales force and through Japanese distributors. Inventory available in Japan.

STATEMENT OF JOHN H. MAKIN

Mr. **Makin**. Thank you, Mr. Chairman. Again, I am pleased to testify before this committee on trade problems related to the level of the exchange rate and to the large debt of developing countries.

The American Enterprise Institute places special importance on the study of American competitiveness abroad and the international aspects of fiscal policy.

Some recent articles which address these subjects are attached to my testimony, and I hope they can be included in the record.

I think, to put this in perspective, it's important to note that the basic issue under discussion here is a strategic one. There is no doubt that U.S. producers are being denied adequate access to foreign markets, and in particular, a number of industries such as telecommunications, forest products, pharmaceuticals, and ceramics are being denied adequate access to Japanese markets.

The strategic issue really is, if U.S. producers lack access to markets, then what shall we do? Shall we deny to U.S. importers—that is, consumers and importers of inputs, who have, as we know, revealed a strong preference for foreign goods over domestically produced goods—should we deny to those groups access to lower-cost foreign products on the expectation that such denial is a strategy to open up the markets to our producers?

I think it's important to recognize that that strategy is not costless, nor is the outcome assured. If no response—suppose we say, "All right, Japan. Don't open your markets. We're closing our markets to your exports, or we're imposing a 20 percent import surcharge on all Japanese goods,"—if there is no response, how long do we propose to penalize American importers with such a strategy?

I think those are things that ought to be thought of before taking the action, rather than after it's taken.

The principal claim supporting this strategy is one that foreign governments are subsidizing their producers, and thereby creating an unfair competitive atmosphere.

It's important to remember that governments have to gain all of their resources from taxpayers. So we have a rather odd image where taxpayers in Japan and Mexico and elsewhere are consistently subsidizing U.S. importers and thereby shutting out U.S. producers. In other words, the notion of unfair foreign competition through subsidies by foreign governments, if it's to be sustained over a long period of time, requires us to believe that foreign taxpayers are interested in subsidizing U.S. importers.

Again, while I recognize that there are some serious problems in some industries, I am not comfortable with a trade policy that overall accepts that proposition.

The chairman has asked a number of times—and I will try to address this question—whether it's essentially an exchange problem we're dealing with or whether it's a special problem, and whether dealing with the deficit would help the exchange rate problem—that is, if we were to adequately address our deficit question, would the dollar depreciate and would that lighten up some of the problems we're having in the trade area?

I think the answer to both questions is yes. I think the fact that the dollar is very strong, is very closely tied to the policy mix in the United States. What is unusual about the past 3 or 4 years is a very expansionary fiscal policy, which has led to deficits which are large enough to cause our Federal debt to rise very rapidly, relative to GNP.

It's not necessarily deficits per se that operate on exchange rates and interest rates. It's the amount or the rate at which debt accumulates relative to the ability to carry it. And I think we've noted that in the past few months, interest rates have come down a bit. I think the main reason that interest rates have come down a bit in the last few months is related to the fact that the U.S. economy is performing a good deal less robustly than it was expected to a few months ago.

The fact that the policy mix has not changed one iota, I think explains largely the continued strength of the dollar. We still have prospective, very large deficits, which was noted earlier in testimony this morning and discussion. The Congress has been unable to act decisively in this area. So I think that there is no evidence to suggest that acting decisively to reduce current and outyear deficits would not help depreciate the dollar and help alleviate the kind of problem that we're discussing here today.

[Mr. Makins' prepared statement follows:]

Statement of
John H. Makin
Director of Fiscal Policy Studies
American Enterprise Institute

Mr. Chairman, I am pleased to testify before this committee on trade problems related to the level of the exchange rate and the large debt of developing countries. The American Enterprise Institute places special importance on the study of American competitiveness abroad and international aspects of fiscal policy. Some recent articles which address these subjects are attached to my testimony, and I hope they can be included in the record.

Let me state briefly at the outset that in my view the growing tension over many specific trade issues would be considerably reduced by a weighted average depreciation of the dollar in the range of 20-30 percent. The only constructive way to achieve a dollar depreciation with action initiated in the United States would be to enact significant deficit reduction measures consisting of 1986-88 spending reductions in the range of $300 billion. Such measures would be sufficient to slow the growth of our national debt relative to GNP and thereby to enable continued reduction in interest rates and eventual restimulation of the economy. In other words, a somewhat tighter fiscal policy coupled with a stable monetary policy would see a depreciation of the dollar accompanying the move to lower interest rates in the United States. An attempt to depreciate the dollar through an aggressive easing of monetary policy, while the economy is still slowing down, could precipitate a very sharp drop in the dollar sufficient to reignite inflationary expectations and thereby to raise interest rates in a manner that reflects only a rise in inflationary expectations. This would amount to a return to the late 1970s when rising interest rates and rising inflationary expectations accompanied a chronically weak dollar. We need a constructive depreciation of the dollar through a drop in real interest rates, and the best way to get it is by slowing the rate at which government debt is accumulating.

The other way to achieve constructive depreciation of the dollar would be through more rapid growth abroad in Europe or Japan. I have urged Japan to consider easing fiscal policy in order to take up the slack generated in that economy by a slowdown of exports to the United States and export-related investment that will likely result from a slowdown in the U.S. economy. (See Wall Street Journal article, May 17, 1985--attached.) Such measures have been suggested for Europe as well. Neither Japan nor the European Economic Community seems inclined to follow such policies at present.

Despite the frustration which accompanies the difficulties of American traded goods industries in the presence of a strong dollar and reluctance by foreign governments to follow stimulative policies, the temptation to take unilateral trade-restricting measures should be resisted. Likely retaliation, the possible need for offsetting controls on capital flows, and the negative effect on consumers have been frequently mentioned as reasons against trade restrictions. Another compelling reason is the likely unfavorable effect on the exports of developing countries and therefrom on their ability to service debts largely held by American banks. It should be remembered that the six largest American banks still have nearly twice their net worth at risk in the five largest Latin American economies. Unilateral trade-restricting measures, particularly at a time when the U.S. economy is slowing down and thereby reducing exports from the developing countries, could negatively affect the health of our own financial system.

Background on the Exchange Rate and American Competitiveness

There is no doubt that American traded goods industries have been disproportionately harmed by the mixture of easy fiscal policy and a monetary policy aimed at containing inflation. Investment incentives contained in the 1981 and 1982 tax acts served as a temporary antidote for some of the negative effects of high real interest rates and a strong dollar. As the tax antidote, consistently with past experience, has worn off during the last year, the distress among U.S. industries that must compete in markets for exported and imported goods has grown acute. It is little consolation to those trying to survive in these sectors to point out that the most constructive way to deal with their problems would have been to pass forward-looking deficit reduction measures in 1984 rather than to wait until 1985 and continue to debate such measures. It remains questionable, however, to relieve the distress of one sector of the economy by imposing additional stress on other sectors. American industries which import inputs or are involved in shipping and commerce and those which would be negatively affected by retaliation against unilateral trade measures would be the losers in the event of imposition of import surcharges or quotas. American consumers would be harmed as well, and is it not clear that such measures always help targeted industries.

The U.S. tax code serves to exacerbate our strong dollar problems. Its idiosyncratic treatment of interest income and expense results in American interest rates which appear artificially high to foreign investors. Liberal provisions for interest deductibility together with taxation of interest income place a tax on lenders while subsidizing borrowers in a manner that pushes up interest rates and induces additional foreign purchases of dollar securities that artificially strengthen the dollar. Measures to index interest income and expense would have put further downward pressure on interest rates and would have served as another way to induce a constructive depreciation of the dollar.

Effect of Debts of Less-Developed Economies on American Trade Problems

As noted above, export dependence of developing economies heavily indebted to American financial institutions further constrain the use of protectionist measures to aid American industry. Temporary protectionist relief for U.S. traded goods industries negatively impacted by the strong dollar risks exacerbating already serious problems faced by America's largest banks. In this context it is important to remember that the world debt crisis is not over. The last two years have seen restructuring and stretching out of payment periods for most debts along with injection of new money by international institutions and commercial banks. Events in 1984 helped to put the debt problem in remission. A U.S. economy that was stronger than had been forecast resulted in LDC exports running above forecast levels. In 1985, however, the situation is changed. LDC exports are dropping, along with the strength of the American economy and the slowing of the European and Japanese economies. Serious inflation and political unrest, particularly in Argentina but also in Brazil, call for additional injections of money and leave open the possibility of unilateral refusal to service debts. A slowdown in the world's industrial economies accompanied by new protectionist measures would increase the likelihood that the "global debt problem" would move to a critical stage where a major debtor fails to service its debts.

It is worth remembering that investors in Europe and Japan are currently far more concerned about the health of the American financial system than are most Americans. The very nervous reaction by foreign investors to savings and loan difficulties in Ohio and Maryland is indicative of this enhanced level of concern. Though logically those problems were very well contained and should not have borne on the overall health of the American financial system, they are a symbol of sensitivity to the ongoing debt problem.

Summary

No one denies the extreme distress in American traded goods industries. That distress has probably been aggravated by investment incentives in the tax code that have accelerated acquisitions of capital equipment. Many of those acquisitions were undertaken on the expectation by capital-intensive American exporters and importers that the exchange rate would not reach a level at which it is virtually impossible to compete with foreign producers. Nor should the fact that investment tax credits apply to acquisition of foreign-produced equipment be overlooked.

The only source of relief that does not harm other sectors of the economy is measures directed at a constructive depreciation of the dollar in the form of deficit reduction in the United States, preferably combined with some stimulative fiscal measures abroad. The remedy sometimes suggested of a new world monetary system is something of a false hope, considering that any monetary system may be designed to promote exchange rate stability, but few would argue that an exchange rate system, whatever its form, can or should try to affect the average level of the exchange rate. And it is the level of the exchange rate that poses the primary problem for many American companies.

In light of the increasing exposure of many American industries to exchange rate uncertainties, it may be prudent to consider longer-range strategies to limit vulnerability to sharp changes in the level or volatility of exchange rates. Some companies are accelerating the movement abroad of production facilities, while others are exploring innovative financing techniques where a company with a consistent receivables position in a foreign currency considers borrowing in that currency to obtain offsetting foreign currency payables as a hedge against the effect of exchange rate changes on earnings.

More broadly, the problems faced by the American economy in 1985 serve as another reminder of the increasing internationalization of this economy and the need to take adequate account of international implications of our macro policy mix and the design of our tax system.

5/17/85

Japanese Tax Cuts for Transpacific Prosperity

By John H. Makin

President Reagan left Bonn empty-handed because he pushed the wrong people on the wrong issue. He tried to get a weak and essentially protectionist Common Market to agree to a new round of trade talks instead of pushing the world's strongest economy to cut taxes. In the process he learned that France, not Japan, is the industrial world's most protectionist nation. Francois Mitterrand was allowed to sabotage trade talks by throwing onto the table a smelly old red herring called a new world monetary system. Still, the exercise will not have been futile if it helps to emphasize the emerging truth that the U.S.'s economic and political future lies more with the Pacific Rim than with Europe.

The best way to expedite freer trade is with continued economic growth, and right now the best way to ensure such growth is through U.S.-Japan economic leadership in the form of Coordinated Pacific Rim Fiscalism that evolves to include Canada and other Pacific Rim nations. The immediate need is for the U.S. to cut government spending while Japan cuts taxes.

The need, if not the will, to cut the U.S. fiscal deficit is well established. The argument lies in whether to reduce the deficit with lower spending, higher taxes or both. Spending cuts are the best way to go. The president may wish to take note that his own much maligned Council of Economic Advisers, in its last annual report, has provided him with the soundest rationale for preferring spending cuts over higher taxes. Chapter 2 of the CEA report explains that tax increases are the most costly way to cut deficits. Raising another dollar in tax revenues costs the economy about $1.45 because higher tax rates magnify existing distortions in the tax system.

Japan can and should cut taxes for two reasons. Its personal saving is running at 18% of disposable income, more than sufficient to meet government and private-sector borrowing needs. For the U.S. personal saving, running at less than a third the Japanese rate, will fall far short of government and private-sector borrowing needs. Japan's high saving rate means that added bond-financed tax cuts can readily be absorbed. In 1984, when government dissaving was running higher than the projected rate for 1985, Japanese savers bought nearly $50 billion in assets outside Japan.

A second and perhaps more compelling reason for Japan to cut taxes lies with the need to keep its own economy growing and thereby to help keep the world economy growing. In 1984, export growth directly accounted for nearly two-thirds of Japan's 5.8% real growth rate. That won't continue with a slowing U.S. economy and a weakening U.S. dollar. Japan needs to stimulate growth with lower taxes aimed at businesses in both export and domestic sectors. Otherwise, the 33% slowdown in investment growth projected by Nomura Research Institute will accelerate, and Japan's slowdown will coincide with sharper slowdowns in the U.S. and Europe.

The idea of a tax cut in Japan is not a call to fire up a fiscal locomotive. Rather, it is a suggestion that while engine No. 1 is backing off on the throttle with some necessary cuts in government spending, engine No. 2 ought to take up some of the slack with a modest easing of fiscal policy. There are two important new ideas here. The first is a suggestion for active coordination of fiscal policy. The second is to concentrate on coordination with Japan. Together they add up to the concept of Coordinated Pacific Rim Fiscalism.

The tendency to ignore fiscal-policy coordination is a carry-over from the Bretton Woods system of fixed exchange rates. Fixed rates made monetary-policy coordination the focal point of international economic discussions, while fiscal policy and particularly changes in tax structure or rates were reserved largely for domestic goals. The move to floating rates reduced the need to coordinate monetary policies. Moreover, theoretical results based on Keynesian models suggested that, under floating rates, fiscal policy was largely ineffective in stimulating the economy. This view followed from looking only at the demand side wherein fiscal stimulation resulted in currency appreciation and a drop in net exports, which to Keynesians is equivalent in its effect on aggregate demand to a drop in investment.

But it is necessary also to consider supply-side effects of stimulative fiscal policy. Deflationary pressure from a stronger currency improves producers' margins and output rises. Further, if tax cuts stimulate investment, the negative effect on demand of a drop in net exports is reduced or eliminated as long as investment continues to be strong. These conditions describe the U.S. economy during 1983 and 1984 and could apply to Japan in 1986 and 1987 if tax cuts are enacted in 1985. Japan's slowing investment growth and the U.S.-Japan trade tensions linked to its weak consumption spending both reinforce the case for a tax cut in Japan.

Even if Japan's movement to an easier fiscal stance increases its fiscal deficit and thereby its national debt, the combination of a tighter fiscal policy in the U.S. with Japan's easier fiscal stance should lower the net increase in world debt. The U.S. economy is approximately twice as large as the Japanese economy. A rough guide for policy might be to suggest that for every dollar of U.S. spending cuts, the Japanese cut taxes on capital by about 50 cents. That would mean that if the U.S. enacted a $50 billion expenditure reduction package for fiscal 1986, a $25 billion tax cut in Japan would still leave global debt accumulation reduced by $25 billion.

The combination of lower government spending in the U.S. and lower taxes in Japan would result in constructive dollar depreciation through a stronger Japanese economy. The problems surrounding the very strong U.S. dollar have led to other policy prescriptions that are counterproductive and just plain wrong. Easier U.S. monetary policy will weaken the dollar but not constructively. The exchange rate could drop very sharply, enhancing a quick return to an inflationary period and double-digit interest rates. Hazy plans for a new or improved world monetary system are not going to affect the ultimate path of exchange rates or the overall level of world economic performance. The world learned that lesson after the breakdown of the Bretton Woods system, and 15 years is just too short an interval over which to have forgotten it. Worse still, the import-surcharge idea is one that never should have surfaced but one whose superficial attractiveness is frighteningly easy to understand. The only positive solution is to hammer out a coordinated plan for an easing of Japanese fiscal policy tied directly to a tightening of U.S. fiscal policy.

Although an opportunity was missed at Bonn, there is nothing to prevent Japan and the U.S. from moving ahead with coordinated spending and tax cuts that would put more than half the industrial world—the major Pacific Rim economies—on the path to a sustained economic expansion. Meanwhile, the Europeans can, if they wish, amuse themselves with discussions of a new world monetary order.

Mr. Makin directs fiscal-policy studies at the American Enterprise Institute.

THE WALL STREET JOURNAL
Published since 1889 by
DOW JONES & COMPANY, INC.
Editorial and Corporate Headquarters:
22 Cortlandt Street, New York, N.Y. 10007.
Telephone (212) 285-5000

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Mr. **Florio**. Isn't the deficit analysis or the deficit reduction analysis tied in with the interest rate reduction expectations as being a primary factor in anticipating the dollar being brought back to something closer to parity?

Mr. **Makin**. In my mind, it isn't primarily.

Mr. **Florio**. It is not?

Mr. **Makin**. It is not. The fact that there is a necessary relationship between interest rates and exchange rates—the suggestion, I think, has to be questioned.

Remember in the late 1970's, American interest rates were rising rapidly while the dollar was falling. The reason was that most of the increase in interest rates was due to rising inflationary expectations. And so putting your money into the dollar meant that you had to be compensated for the expected depreciation of the dollar's purchasing power.

Now we have a situation where the economy is slowing down, and at the same time inflationary expectations are coming down. And so interest rates are coming down, and the dollar still looks like a good bet, because the purchasing power of the dollar looks very good.

Mr. **Florio**. The difficulty I have with that sort of analysis is, the economy is slowing down, and in order to compensate for the economy slowing down, we are pumping more money into the economy—the Federal Reserve process is doing that—but we are not seeing what one would expect to see in the way of inflationary pressure resulting from the pumping of money into the economy in large measure because of the strong dollar and the pressure from overseas imports being able to keep a lid on prices that would normally go up. Overseas imports are, in fact, a factor in ameliorating inflationary pressures.

I mean, we're into almost a catch-22 situation where the decimation of many of our industries and the flood of imports is a very beneficial factor in keeping inflation down, so that we can go and do what we normally would not want to do, which is to pump money into the economy, when we already have a massive debt that is fueling economic growth, but is not fueling economic growth. We're just in that literal explanation—I mean, we can talk about woodenheaded governmental policies, but the fact of the matter is, all of the experts that we have before our committees, the economists, each and every proposal to deal with the problem yields problems that are more significant in some respects than the problems we're trying to adjust to.

I suppose I'm just manifesting my frustration. But it is a very difficult thing to deal with, because, as I say, we appear to have gone so far down a particular path that is so untried. No one has ever talked about $200 billion a year deficits before. We seem to have burned all the bridges behind, so that we're in a no man's land and that no one knows what are the traditional approaches to be advocated.

Mr. **Makin**. As an economist, I've become familiar with the woodenheaded economist as well. Certainly a number of things have come to pass over the past 4 years, since this experiment with fiscal policy was initiated.

I think that there are really two things that are very different now that we did not see in our past experience. One, as you say, Mr. Chairman, is the very large deficit. Another way to look at it is, you know, it took 200 years to accumulate a $700 billion national debt, and that was by 1977. We redoubled our national debt again by 1984 and will redouble it again by the end of the decade.

Mr. FLORIO. Is it fair, though, to say that that deficit in large measure is the cause of the economic boom that we are theoretically in, in the sense it's not too terribly—it is described as supply side economics, but it really is not too different than traditional pump priming; that what we are doing is fueling the boom that we have had on the basis of borrowed money that is represented by the deficit?

Mr. MAKIN. I would say that we have had a boom. I would remind anyone who will listen that 4 or 5 months ago, the forecasts were for an economy that would grow at about 4 percent over the first half of this year. Based on the first quarter numbers and the flash for the second quarter, the economy has grown at an average of 1.7 percent, so I would venture the suggestion that our strong recovery is over, and the main reason our strong recovery is over is that the temporary expedients undertaken to stave off the damaging effects of high real interest rates—that is, the investment stimulation measures—have worn off, as they always have.

So that we are now in a situation where the options to deal with the economy are much limited. Debt accumulation, really the best way to describe what it does is it limits your options, and I think we are here talking today about a serious trade problem, and again, the point that I'm trying to emphasize is that yes, it's there and it's specific to a number of industries, but that it may not be great enough to justify a kind of sledge hammer approach to the problem.

I think most of the people that I have talked to—and I have spent a lot of time speaking with people in the forest products industry and in the telecommunications area and in the ceramics industry—are willing to agree that if every measure that they wished to have undertaken to expedite their access to the Japanese marketplace were done, that if you look at a $37 billion to $40 billion current account deficit with the Japanese, you would get a reduction over a few years of about 10 percent.

So it's not that there are not extreme problems in some areas. I am just saying that there are some very basic things going on, the very large deficits.

The second thing I wanted to mention was the fact that this is a decade when the rate of inflation keeps coming down and keeps coming in lower rather than higher than was expected. That is a big change, and it means for commodity-oriented industries like forest products, and it means for heavily leveraged industries like agriculture that have to borrow a lot of money and may mortgage their land in order to do so and count on a higher price for their product, it means extreme distress for those industries.

Really the problem is going back to a time when in the seventies we said time and again, well, we are going to slow down inflation, and every year inflation came in higher. So people adopted means of adjusting to this and dealing with it. It was borrow more, sell more, borrow more, borrow more, and that always paid when inflation came in higher than expected. When it comes in lower than expected, the whole process runs in reverse.

Mr. **Florio.** Would it be fair to say, as I have said earlier, that part of the ability to control inflation is a result of imports; also the point that one of our labor representatives made here earlier is that as we lose manufacturing jobs and they are replaced in part—not even totally—but replaced in part by service jobs. The comparable rate of compensation is not even, and that in fact means that over a period of time, the overall standard of living, a component of which is wages, is going to go down. As a result, the impact of those counter-inflationary forces I suppose, the work force as a major commodity is not good from those types of developments?

Is that a fair analysis?

Mr. **Makin.** I think it's fair. I would say, again, that the basic problem, all of these things are flowing from the fact that we have to sell either the rest of the world or investors in the United States a much larger quantity of government debt than we have in the past. And you are right, that the fact that we have to do that, the fact that we are running policies which mean we are going to be pushing up the real interest, the inflation-adjusted interest on that debt, means that foreign investors find it very attractive to buy those securities, and in the process of doing it, bid up the dollar and thereby cause a spillage of the normal inflationary pressure that would follow from monetary expansion, and I agree with you on that.

I would add that it also creates a very delicate problem for the monetary authority because if when the economy does slow down an effort is made, as typically has been in the past, to restimulate the economy by increasing the rate of growth of the money supply—and I'm sure you have noted, Mr. Chairman, that that growth rate has accelerated quite rapidly in the past 6 months—there is a kind of a point beyond which you might go too far, turn the whole process around, have a rapid drop in the dollar, and then you do have more inflation, you do get a sharp weakening of the dollar, and you may get such a sharp weakening of the dollar that we get back into a situation that we saw in the late seventies where the dollar was weakening while interest rates were rising.

Mr. **Florio.** Can you conceive of a situation where interest rates in this Nation will fall below interest rates in the other industrialized nations? The argument has been with regard to interest rates that, well, when the interest rates come down, people will take their money out of our market and go someplace else; but there seems to be almost a parallelism with interest rates because we are talking about an international economy, and so it seems to me to be farfetched to think that as our interest rates come down, someone is going to go to some other country where the interest rates are going to track ours fairly closely and then you are not going to have a development where interest rates go up in Europe and interest rates come down in this country, prompting the exodus of investment dollars out of our economy.

Mr. **Makin.** I think that is an important question and I think it is one that needs more attention.

Let me suggest that when you look at two things—one, the level of saving in the United States, and second, the way that we treat borrowing and lending in this country for households—my testimony lays this out in detail, but I can be very brief.

Essentially what is special about the United States with regard to its saving is not that it is very low relative to Japan but that it is very low relative to everybody. Most saving rates cluster closer to Japan's rates than they do the United States, and there are a number of reasons for this. One that I have chosen to emphasize or have emphasized is tax treatment of interest income and expense for households.

The fact that interest expense is fully deductible is a subsidy to borrow, and the fact that interest income is fully taxed is a tax on lending. The result is a higher interest rate. Borrowers and lenders in this country, knowing the tax treatment of interest income and expense, borrowers are willing to pay a higher rate.

One of the things we have seen in this period of high interest rates for consumers is that consumer debt is continuing to rise rapidly, and most people tell me: well, it's deductible. In other words, American consumers can endure much higher interest rate than they can in Europe or Japan where interest expense is not deductible.

So we have a Tax Code problem here. Our Tax Code subsidizes borrowing and taxes lending. It means that the interest rate can be quite high here, whereas when a Japanese saver or a European saver looks at interest rates here and has a situation where they are not taxed on interest income, what you have is a stronger dollar than you otherwise would have. They want to come in and earn those high dollar interest rates, and then when they come back to their tax system, the after-tax return is very high.

Mr. **Florio**. The argument, of course, that we hear when anyone talks about changing those tax laws is that what you are doing is providing disincentives for borrowing for investment purposes and that that is counterproductive.

Mr. **Makin**. I certainly heard a lot of those arguments when I suggested this, and I think the answer to that is that there are other ways to deal with the investment incentives, particularly having to do with indexing for depreciation, indexing for inventories, possible special capital gains treatment.

But let me turn the argument around and say that where these provisions are not present, say, in Japan or Europe, you get one conclusion or the other, but certainly investment is alive and well in Japan, and in Canada, I might add, where these provisions are essentially the reverse of what they are in the United States.

Mr. **Florio**. I have asked most of the questions I wanted to ask as we went forward, and we are going to have to go. Let me just ask a question, if you don't mind, Mr. Asher.

The Commerce Department has told us that a large share of the semiconductor imports coming to the United States are imports from U.S. subsidiaries based overseas. If, in fact, your 301 petition resulted in the imposition of import restrictions, wouldn't U.S. companies as well as foreign companies be affected?

Mr. **Asher**. First, Mr. Chairman, as we have stated, the primary objective of the petition is aimed at access to the Japanese market as opposed to any restrictions on imports into this market, to some extent due to the reasons that you have just mentioned. However, the United States companies producing and selling, for instance, in Japan sell predominantly into the Japanese market. They are based there in order to sell into the Japanese market.

Now, to the extent that there would be any kind of quotas or surcharge restrictions, should that ever develop, that, in fact, would affect the U.S. producers bringing their products produced offshore back into the United States as well.

So again, the objective of the petition is to achieve the access to the Japanese market, and not to shut down access or to restrict products coming into the United States market.

Mr. FLORIO. But you appreciate the argument being made by some—and Dr. Makin made the point—that the only way you are going to get access into the Japanese market or other markets overseas is by the leverage of threatening or, in fact, imposing sanctions on access to this market.

I think your testimony was that some of the traditional barriers, quotas, tariffs, have been, in fact, reduced. It has been represented to me that unofficial procurement policies, that are very subtle and very difficult to isolate, between governmental entities and actually procurement officers for corporations are a major factor in discouraging products being brought into the market, such that you have the 10 percent pretty much straight through.

How is it that you deal with something of that sort other than by measuring what market access results in in terms of dollar volume? I don't know how you deal with the subtle customs problems and procurement problems, other than market share determinations.

Mr. ASHER. If I might, I think perhaps in retrospect one of the failings in the strategy, if you will, of the high tech working group agreement was that it, in fact, went through and delineated, I believe it was, eight or nine specific areas in which Japan committed to do these various things, including guidance, if you will, to the procuring companies, and it was specific in the actions to be taken.

Probably if you were to go and examine, and certainly in the early stages of the agreement when we were visiting many times the various consumers, you could state that, yes, in fact, those actions have been taken, and yet the 10 percent remains.

That is why in the petition, and certainly the approach we have taken at this time is we are not trying to tell and we are certainly not in the position to dictate to the Japanese Government and the companies exactly how they implement the access. Basically what we are saying is that we believe that we should achieve market share equal to that which the Japanese companies are achieving in the United States.

That can be done only by the conscious decision of those companies and the government that it is, in fact, in their best interest to do so.

I will not deny that in the end the one leverage factor you have is access to the U.S. market.

Mr. FLORIO. Well, that is just so obvious. We had Under Secretary Olmer here 3 months ago, saying that while he was negotiating these points of principle—and I don't want to misquote him, but it seemed to me the message that came across was, people can agree in principle, but the implementation doesn't result in anything, and that the only objective way to make some determination that something had been accomplished, even after everybody had agreed in principle, was to see the effect on actual dollar market share. The leverage to achieve that—because the Japanese, in this instance, are not particularly enthusiastic about that as a standard—that the only way to ensure that that standard be followed is with the threat or, in fact, the ultimate closing of our market to induce agreement to provide access that can be determined by dollar market shares.

Mr. **Asher**. Well, certainly in the course of the process the 301 petition will flow through, at the end in the 12-month period, if a satisfactory resolution is not reached, lies the requirement and/or the options to take unilateral actions. It is just that our position is that we believe that with that lying out there, our government should now be able to pursue a satisfactory solution within the 12-month timeframe so that the necessity of the President recommending unilateral action will not be necessary.

Mr. **Florio**. My last point is that in the bill last year, new authority was given to the President to negotiate high technology agreements with other countries. Presumably that has not worked or I suspect you wouldn't be filing your 301 petition.

Has there been any effort to utilize that authority, that you know of?

Mr. **Asher**. Not by SIA particularly, primarily because of our participation in the work group agreements prior to that legislation having been passed, and I believe that—and this is just my opinion—that probably the resurrection and the establishment of the Moss talks have to some extent blunted, pending how they turn out, any further action within that authority.

Mr. **Florio**. We have a vote, and we have to vacate the room anyway.

Let me express my appreciation to both of our witnesses and thank you very much for your help.

If there is no further business to come before the committee, the committee stands adjourned.

[Whereupon, at 1:33 p.m. the hearing was concluded.]

TRADE LAW MODERNIZATION ACT

THURSDAY, OCTOBER 3, 1985

House of Representatives,
Committee on Energy and Commerce,
Subcommittee on Commerce,
Transportation, and Tourism,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2322, Rayburn House Office Building, Hon. James J. Florio (chairman) presiding.

Mr. Florio. The subcommittee will kindly come to order. I would like to welcome all in attendance today to the subcommittee's second hearing on the Trade Law Modernization Act. Since our first hearing approximately 2 months ago, trade has clearly moved to the center stage of issues in the U.S. Congress. The President has announced a new U.S. trade policy which includes a commitment to intervene in international currency markets to bring down the inflated value of the dollar, and has made a number of other proposals that perhaps we will go into a bit today.

Many of the proposals which have been made are dealt with in the legislation that is before us, and therefore, we are extremly interested in completing the subcommittee's consideration of this proposal at the earliest possible time so that it can be transferred to the full committee for their early consideration.

I would yield at this point to the gentleman from New York.

Mr. Lent. I thank you, Mr. Chairman. First of all, I want to applaud your initiative in reviewing H.R. 1950, which is a major piece of trade legislation referred to the Energy and Commerce Committee, and I look forward to a far-ranging discussion of trade issues that this legislation will provide for the subcommittee.

Everyday we read of major U.S. companies moving facilities abroad or, even worse, choosing to buy billions of dollars in supplies and equipment from foreign suppliers at the expense of American products. This imbalance in trade is the result of many factors, but one major cause in my opinion is the lack of a clear, strong trade policy which seeks open markets overseas and competitive pricing and importation at home. Subsidized, counterfeit, or dumped goods should not be welcome in our markets because they derive their competitive advantage unfairly.

H.R. 1950 proposes to strengthen our ability to respond to such practices and to assure that these imports do not flood our markets as a result of legal delays or unclear statutory language. I expect we will explore other approaches to this problem.

Our trade problems require reasonable, careful solutions and I'm pleased that H.R. 1950 seeks to improve the existing legal framework to achieve just such a result. And I'm very gratified that the sponsor of that momentous piece of legislation graces our Chamber here this morning, and I look forward to hearing from him, and welcome him to the subcommittee, Mr. Guarini.

Mr. FLORIO. Thank you very much. We are now pleased to have as our first witness at this hearing the chief sponsor of the bill H.R. 1950, a leading member of the Ways and Means Committee, particularly in terms of trade, our sister committee that shares your section with us in the matter of trade. So we are pleased to have my colleague from New Jersey, the Honorable Frank Guarini, as our first witness.

Welcome to our subcommittee.

STATEMENT OF HON. FRANK J. GUARINI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. GUARINI. Thank you very much, Mr. Chairman, and my good colleague, Mr. Lent. I want to express my appreciation for your having me here to discuss H.R. 1950, and particularly for the concern and interest that your committee has shown in trade law modernization.

You are right, trade certainly has moved to center stage. We are very, very concerned about the imbalance of trade and the great deficit that has accumulated in the last 4 years.

I would like to submit a copy of my statement for the record.

Mr. FLORIO. Without objection the statements of all our witnesses today will be put into the record in their entirety.

Mr. GUARINI. And I will just make a few comments instead of going through the lengthy statement that I have just submitted.

The trade imbalance everyone knows is now $150 billion a year and growing. We were alarmed 4 years ago when it reached $23 billion a year. Translated in terms of jobs, we estimate it means a loss of 3 million jobs in our employment sector in this country. Seventy percent of the products that we make here, domestically, face import competition.

We are particularly concerned with the impact the trade imbalance has on our economy and feel that there are perhaps many problems in our trade situation today. One, we don't have a national trade policy, we have no strategy for trade, and we politicize trade more than we should. We certainly have left ourselves free and open while other countries have closed their markets.

We have been a lead proponent of GATT and this piece of legislation which is now cosponsored by 85 Members of the House on a bipartisan basis. Congressman Duncan, the ranking member of the Republican side of the Ways and Committee is a prime cosponsor with me, and Senator Heinz and Senator Baucus in the Senate have taken an active role and sponsored the bill in the Senate.

I think that there are perhaps many parts to the problem. One of the issues that we call for is a new GATT round. Now, we have had two GATT rounds that have lasted 5 years each; the Kennedy GATT round and the Tokyo GATT rounds, and they were on the

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easier questions. The first one was for the sake of setting the tariffs. The second one got rid of some of the nontariff questions.

But the hard questions were left, and the question that concern Government procurement such as the problem that we have with Japan today is certainly a prime one. And the subsidy question, the intellectual property rights, counter-trade which is barter—that has become very more prominent in recent years.

Some of these areas have become very sticky questions and this piece of legislation calls for another round of GATT, but we must not delude ourselves to think that it's going to happen quick. This is going to be 7 to 10 years before we get any conclusion, and the conclusion will probably only be a compromise.

There are other questions that are left open such as the hard dollar, which gets down to the deficit, and of course trade imbalance ties into that. And the research and development which is part of the tax package that is under consideration today, giving tax credits of 25 percent, is perhaps another arrow in the quiver. And the antitrust laws are stacked up against our country.

What we really have done here in H.R. 1950 is attack a very important pillar of the whole trade edifice, and that is to have a trade law modernization bill. Our trade laws are archaic; they do not help our industries, they do not give us an even playing ground with our trading partners. It makes it very difficult, almost impossible, to bring cases and to get relif in time.

The rules of evidence are hard against our own companies; they require in section 201 substantial evidence; not just evidence of injury, substantial evidence of injury, that allows for no temporary relief, which in every court system in every manner we have injunctive relief, equity, is done. And there is no provision made for that.

In section 301 we have added targeting, which of course is a common practice with some of our trading partners that prey on American markets, which puts us at a complete disadvantage. And we have provided more power for the USTR or administrative authority, as we call him.

What we want to do is depoliticize trade as much as we can. Going back a number of years ago, the State Department, for the sake of national policy, always sat at the head of the table, with Trade at the side. The Secretary of State and the governmental agency was set up after World War II and was the key dominant figure. And we now are beginning to get away from that somewhat, but we still have a great domination where our trade is often used as a tool of political policy.

National policy in Nicaragua, for instance; as soon as we cut off trade with Nicaragua we lost many jobs in this country here, but France, which did not go along with us, neatly picked up all the trade that we had lost when we created the embargo.

So we see that we want to put more authority and more power in the hands of the administrative authority, or the USTR, where he would be responsible both to President—being a member of his Cabinet—as well as to Congress. And that the President would be required to have a report every year, and set national goals for trade policy. That we would have boards that would be created within industries where labor and management and Government can sit together and can work.

We've learned a lesson from MITI where there has been cooperation within industries. They can work together as a partner. We don't have that happening; we have an antagonistic instead of a protagonistic system within our particular industries.

We have a number of items that we were addressing which deal with strengthening our trade remedies and making available a procedure to our people where we will live under GATT, where there's no protectionism that's involved at all. It would be fair trade. There is no such thing as free trade.

But if we look at the whole totality of all the items that we are speaking of, we would, in short, totally give more authority to this administering authority where he can go through the whirl instead of being a person who doesn't have the portfolio he needs to make decisions, to let him make decisions, to give strategy advisory boards for all our particular industries, to give us a national trade policy, a working relationship where Congress will play perhaps a little larger role.

As you know, under the Constitution Congress was the branch where the framers of the Constitution put the regulation of trade with foreign nations. We alone had that jurisdiction until that was given up by Congress in the years of history that had preceded, particularly after World War II.

Congress should strengthen Government procurement codes the escape clause, and make it more palatable for industries to seek relief. We should also attack subsidies, of the biggest problems we face.

And then we have the two-tier operation of the natural resources which is a pressing problem and we would address ourselves to this particular problem. We had it in our legislation and it got struck out last year, and hopefully it will be put back in.

That, in essence, is a general summary of what the Trade Law Modernization Act is. It gives us a level playing ground, to use that old, although often trite cliche, but it gives us the ability to ask for reciprocity with other countries; a fast track legislation where we need help, give equity or injunctive relief where it needs help, and at the same time, treat other countries as they treat us; that we are no longer to be always the free and great and open nation where other people close their doors, have trade barriers and non-trade barriers so that we have no access to their markets.

These are the parameters that the bill addresses itself to. I just gave you a brief summary of the various provisions such as Government procurement and subsidies and natural resources that we tried to pull together. It has tremendous bipartisan support; it has support of labor and industry. We are having an ever-growing number of sponsors on the legislation, and I think it is very, very timely for your committee to consider markup and I understand at the same time, after you are finished it will go to the Ways and Means Committee for their concurrent jurisdiction.

And hopefully, we will be able to have a bill that the people who are in our domestic manufacturing section can say that they now are treated fairly by our own administrative process, that we are living under GATT as an equal member with all other members of the world.

We've done a lot for many of our trading partners. We've had the Marshal Program, we've pegged the dollar against gold to satisfy other countries after the war when we were the only industrial nation that was standing. We have given the benefits of trade considerations and tariffs to all our partners every time we have negotiated under GATT, and I think the time has come, and the time has come now, to say that we have had enough; that we want to be treated equally and fairly with all our trading partners. The time has come for the United States to stand up and say, we are going to protect our own jobs, our own people and our own industries.

Thank you.

[The prepared statement of Mr. Guarini follows:]

TESTIMONY OF HON. FRANK J. GUARINI

I WANT TO THANK THE SUBCOMMITTEE ON COMMERCE, TRANSPORTATION AND TOURISM FOR INVITING ME TO BE WITH YOU THIS MORNING. MY THANKS TO YOUR DISTINGUISHED CHAIRMAN, MY NEW JERSEY COLLEAGUE, AND MY FRIEND JIM FLORIO FOR HIS INTRODUCTION AND HIS LEADERSHIP ON THE TRADE ISSUE. IT IS A PLEASURE TO DISCUSS WITH YOU THIS MORNING MY BILL, H.R. 1950, THE TRADE LAW MODERNIZATION ACT.

WE CANNOT EXPLORE THE NEED FOR TRADE REMEDY REFORM WITHOUT EXAMINING HOW THE UNITED STATES IS FARING IN THE CURRENT WORLD TRADE PICTURE.

OUR ABILITY TO COMPETE HAS BEEN IN SERIOUS DECLINE. FOR THIS ENTIRE CENTURY--UNTIL 1971--THIS NATION HAD A SURPLUS IN ITS BALANCE OF TRADE. TODAY, OUR TRADE DEFICIT HAS SET A RECORD HIGH FOR THE PAST FOUR YEARS IN A ROW, A DRAMATIC REVERSAL. OUR MERCHANDISE TRADE DEFICIT HAS INCREASED SIX TIMES IN FOUR YEARS, AND ANALYSTS ARE PREDICTING A 1985 TRADE DEFICIT OF $150 BILLION. WE ARE LITERALLY GIVING AWAY THE COMPANY STORE.

THE COST OF THIS TRADE DEFICIT IS ENORMOUS. OUR LARGEST EXPORT THIS YEAR HAS BEEN JOBS--ALMOST 3,000 A WEEK LOST. OUR DEFICIT TRADE POSTURE HAS MEANT THE LOSS OF 3 MILLION JOBS. EVEN IN HIGH TECHNOLOGY, WHERE WE ONCE EXCELLED, THE U.S. HAS LOST A LARGE SHARE OF THE MARKET.

THERE ARE MANY REASONS WHY WE HAVE LOST GROUND IN WORLD TRADE. TODAY, 70 PER CENT OF ALL PRODUCTS PRODUCED IN THE U.S. FACE IMPORT COMPETITION. BECAUSE THE U.S. IS SO LARGE AND OTHER MARKETS ARE FREQUENTLY CLOSED, OUR MARKETS HAVE BECOME TARGETS FOR COUNTRIES LOOKING TO ADVANCE SEGMENTS OF THEIR ECONOMY OR IN NEED OF HARD CURRENCY.

AMERICAN MANAGERS WERE NOT PREPARED FOR THE DEVELOPMENT OF TRADE. DECISIONS MADE WELL INTO THE 1970s WERE MADE ON THE BASIS OF THE TRADING ORDER THAT EXISTED AT THE END OF WORLD WAR II. FEW PEOPLE TOOK JAPAN SERIOUSLY, AND EVEN FEWER PEOPLE WERE LOOKING AT THE INDUSTRIALIZING NATIONS OF THE FAR EAST.

TECHNOLOGY HAS BECOME HIGHLY MOBILE, AND THE PACIFIC RIM COUNTRIES HAVE USED IT TO THEIR ADVANTAGE. FOR EXAMPLE, SINCE THE DEREGULATION OF OUR PHONE INDUSTRY, JAPAN AND THE ASEAN COUNTRIES HAVE MOVED QUICKLY TO GRAB A RAPIDLY INCREASING SHARE OF AMERICA'S TELECOMMUNICATION MARKETS. YET THEY HAVE SLAMMED THE DOOR ON PROCUREMENT IN THEIR OWN TELECOMMUNICATIONS MARKETS.

AMERICAN WORKERS ARE COMPETING AGAINST FOREIGN TARGETING OF OUR INDUSTRIES, LOWER WAGES, FOREIGN GOVERNMENT SUBSIDIES, DUMPING PRACTICES, AND MANY RESTRICTIONS CONTRARY TO THE SPIRIT OF FREE AND FAIR INTERNATIONAL TRADE.

AMERICAN WORKERS ARE ALSO COMPETING AGAINST THE STRENGTH OF THE DOLLAR. THE RECENT YEARLY DEFICITS HAVE PUSHED OUR NATIONAL DEBT TO $2 TRILLION, BUT THERE IS NO APPARENT ALARM ON THE PART OF THE ADMINISTRATION. THE NUMBER OF DOLLARS NEEDED TO FUND OUR RED INK HAS SOARED TO THE POINT ($147 B) WHERE OUR DEBT SERVICE IS THIRD ONLY TO NATIONAL DEFENSE AND SOCIAL SECURITY. BECAUSE OF OUR RECORD-HIGH NATIONAL DEBT AND OUR HUGE TRADE DEFICIT, THE U.S HAS BECOME A DEBTOR NATION FOR THE FIRST TIME SINCE WORLD WAR I.

U.S. LEADERSHIP IN WORLD TRADE IS DECLINING. WE MUST MOVE TO REVERSE THIS DETERIORATING SITUATION. THE NEED TO ENACT H.R 1950, THE TRADE LAW MODERNIZATION ACT, IS CLEAR.

ENACTMENT OF H.R. 1950 PUTS CONGRESS ON RECORD WITH THIS ADMINISTRATION THAT WE SUPPORT THE NEED FOR A NEW ROUND OF MULTI-LATERAL TRADE NEGOTIATIONS. THE PRESENT GATT RULES ARE OUTDATED AND NO LONGER ACCEPTABLE. THESE INTERNATIONAL LAWS PUT OUR OPEN AND FREE SOCIETY AT AN UNFAIR DISADVANTAGE.

THE NEED FOR A NEW ROUND OF GATT TALKS IS CLEAR. WE MUST PUSH FOR CHANGES IN THE SUBSIDIES CODE, PROTECTION OF INTELLECTUAL PROPERTY RIGHTS, ELIMINATION OF NON-TARIFF BARRIERS AND ABUSES IN COUNTERTRADE, MODERNIZATION OF TRADE REMEDY RULES AND GOVERNMENT PROCUREMENT CODES, AS WELL AS THE BROADENING OF GATT TO INCLUDE AGRICULTURE AND SERVICE INDUSTRIES.

WHILE EFFECTING CHANGES IN INTERNATIONAL RULES IS NECESSARY, IT IS A LONG AND ARDUOUS PROCESS. BOTH THE KENNEDY AND TOKYO ROUNDS TOOK SEVEN YEARS EACH TO COMPLETE. AS A PRELUDE TO THESE TALKS CONGRESS MUST DEMONSTRATE TO THE WORLD THAT WE ARE SERIOUS AND REVISE OUR DOMESTIC LAWS TO DEAL WITH CURRENT TRADE ABUSES.

H.R. 1950, THE TRADE LAW MODERNIZATION ACT, SETS FORTH THE OBJECTIVES OF U.S. TRADE POLICY AND DEFINES OUR TRADE NEGOTIATING GOALS. IT IS IMPORTANT FOR CONGRESS TO APPROVE SUCH A SET OF GUIDELINES AND IT IS EXTREMELY IMPORTANT FOR OUR COUNTRY TO HAVE SPECIFIC POLICY OBJECTIVES WHICH SAFEGUARD OUR INDUSTRIES AND JOBS AT HOME. LET US NOT FORGET THAT THE CONSTITUTION GAVE THE POWER "TO REGULATE COMMERCE WITH FOREIGN NATIONS" TO CONGRESS. CONGRESS SHOULD NOT RELINQUISH THIS CONSTITUTIONAL MANDATE BUT RATHER ACT WITH AUTHORITY AND DISPATCH.

THE OVERALL PURPOSE OF THIS BILL IS TO MAKE OUR LAWS MORE RESPONSIVE TO AMERICAN WORKERS AND FIRMS THAT ARE INJURED BY IMPORTS. RELIEF, IF GRANTED, OFTEN COMES TOO LATE TO HELP THE DOMESTIC INDUSTRY. THIS LEGISLATION ALLOWS TEMPORARY RELIEF (EQUITY) TO PETITIONING INDUSTRIES IN SERIOUS TROUBLE UNDER SECTION 201, THE ESCAPE CLAUSE. THIS BILL ALSO ATTEMPTS TO DEPOLITICIZE TRADE REMEDY LAWS BY PUTTING TRADE POLICY DECISIONS IN THE HANDS OF AN ADMINISTERING AUTHORITY, SOMEONE LIKE THE USTR, WHO MUST RESPOND TO

BOTH THE PRESIDENT AND THE CONGRESS.

THERE IS INNOVATIVE LANGUAGE REVISING SECTION 201 TO ESTABLISH A MECHANISM THAT ALLOWS COMPANIES TO DEVELOP A STRATEGY FOR SURVIVAL, AND THEN GROWTH. WHEN A COMPANY FILES FOR RELIEF, IT MUST SUBMIT ITS GAME PLAN FOR REGAINING ITS COMPETITIVENESS. THIS STRATEGY IS TO BE DEVELOPED BY A HISTORIC BUSINESS-LABOR-GOVERNMENT PARTNERSHIP THAT WORKS TOGETHER AS A TEAM IN HELPING TO OVERCOME OUR TRADE DIFFICULTIES--A PARTNERSHIP WHICH I HOPE WILL SET A PATTERN FOR ALL OF OUR ECONOMIC RELATIONS IN THE NEAR FUTURE.

H.R. 1950 ADDRESSES THE PROBLEM OF BROADER MARKET OPPORTUNITIES FOR U.S. PRODUCERS, PARTICULARLY IN THE AREA OF GOVERNMENT PROCUREMENT. INDUSTRIAL TARGETING BY ANOTHER NATION WOULD BECOME SUBJECT FOR THE FIRST TIME TO OUR TRADE REMEDY LAWS, AS WOULD THE TWO-TIER PRICING OF NATURAL RESOURCES. THE ADMINISTERING AUTHORITY WOULD BE ABLE TO TAKE STRONG MEASURES FOR ENSURING EQUAL MARKET ACCESS AND FINALLY RECEIVE FOR THE U.S. THE SAME FAIR TREATMENT WE HAVE EXTENDED FOR MANY DECADES.

WE MUST SEND A SIGNAL TO THE ADMINISTRATION AND OUR TRADING PARTNERS--A SIGNAL THAT WE ARE TIRED OF BEING THE MOST OPEN, FAIR, AND FREE MARKET IN THE WORLD, WHILE BEING VICTIMIZED BY CLOSED MARKETS AND UNFAIR TRADING PRACTICES.

H.R. 1950 CLEARLY SPECIFIES A WELL DEFINED, ASSERTIVE U.S. TRADE POLICY. WE HAVE EVERY RIGHT TO PROTECT OUR BEST INTERESTS AND ASSURE OUR WORKERS AND BUSINESSES THAT THEY WILL RECEIVE RECIPROCAL TREATMENT. WORLD LEADERSHIP SHOULD NOT BE TANTAMOUNT TO SUPPORTING THE REST OF THE WORLD. WE MUST BE FIRM, TOUGH AND RESOLUTE.

THE ISSUE BEFORE US IS OUR COMPETITIVE STANDING: GETTING THE DOLLAR DOWN THROUGH LOWERING OUR DEFICIT, REFORMING OUR TRADE REMEDY LAWS TO REFLECT CURRENT REALITIES, AND ENHANCING U.S. EXPORT POTENTIAL.

THE U.S. POSITION AS A WORLD LEADER, THE ABILITY TO PROVIDE A RISING STANDARD OF LIVING FOR OUR PEOPLE, OUR CAPACITY TO DEFEND OURSELVES, AND THE MEANS OF GOVERNMENT TO FUND DOMESTIC PROGRAMS--ALL OF THESE GOALS DEPEND ON THE ABILITY OF AMERICAN INDUSTRY TO COMPETE BOTH AT HOME AND ABORAD. OUR COUNTRY DESERVES NO LESS.

H.R. 1950 IS A COMPREHSIVE, CAREFULLY CRAFTED, BALANCED TRADE BILL THAT IS NOT SECTOR SPECIFIC. IT IS CONSISTENT WITH GATT AND IT IS NOT A PROTECTIONIST RESPONSE TO OUR TRADE PROBLEMS. IT HAS BROAD BIPARTISAN SUPPORT WITHIN CONGRESS--92 COSPONSORS TO DATE. IT ALSO HAS BROAD SUPPORT IN BOTH THE LABOR AND BUSINESS COMMUNITIES. OUR COUNTRY WOULD BE SERVED WELL BY PASSAGE OF THIS LEGISLATION.

I APPRECIATE YOUR ATTENTION TO MY BILL AND MY TESTIMONY. I WILL BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE. THANK YOU.

Mr. FLORIO. Let me express our appreciation to you and just—well first of all I'd like to know if you're in a position to give us some indication as to when the Ways and Means Committee might be in a position to take this bill up. The expectation over here is that if we act this week—and I think the subcommittee is inclined to do so—or to act next week, that our full committee is inclined to work within the next 2 weeks to get the bill through. Can you give us any tentative timetable at Ways and Means?

Mr. GUARINI. I would assume that immediately upon our finishing our full attention to the tax reform, which the chairman of our committee, Dan Rostenkowski, is looking to 3 or 4 weeks because we have had hearings over the last year, we've really had many executive sessions, and we are seriously beginning as of today to start going through section by section of the code.

So I have been told by the chairman that the first moment that we're finished with tax reform, which should be about 3 or 4 weeks from now, that we would take the first piece of business up which would be this trade law modernization bill and the other trade matters that we're concerned with.

Mr. FLORIO. Let me just ask one question, in a sense almost playing the devil's advocate. How would you respond to the criticism that some might make that there is already sufficient discretion in the law to allow an administration, if an administration wanted to, to take the actions necessary to achieve the goals that are spelled out, but if an administration doesn't choose to do so—as has been the case up until this point—nothing you're going to have in this law is going to force anyone to do anything if they don't desire to do so. As an example, the 201 case brought by the shoe industry.

In the shoe industry one of the things you're trying to do is to make it easier to overcome the hurdle to make the demonstration that the industry is being injured. There's an industry that has gone through all the hurdles, made the finding and has been able to make the case that they were injured, and still no action has taken place.

For example, there's nothing in this bill as I read it that will provide any remedy to the shoe industry other than what they have now, which is to be at the discretion of the administration as to whether sanctions or relief would be provided.

Mr. GUARINI. Well, there is a very strong attempt to depoliticize the Office of the USTR, but still, he is in the Cabinet, and still the executive officer implements our—the chief executive officer—our laws that we pass. If he does not have the political will, of course, any laws that we pass will have great difficulty.

Mr. FLORIO. Are you saying that the expectation in shifting the ultimate responsibility—for example under 201—from the President to USTR or to the Secretary of Commerce somehow is going to induce that authority to make a decision that would be separate and apart from the decision that, in this case, the President is making? Is it realistic to expect that to happen?

Mr. GUARINI. Well, the President has many things on his agenda, and the way it is now, this must go to the President's desk, so that he is crowded, with maybe a short attention span for an important trade consideration. Whereas if it goes to the USTR's desk and doesn't go directly to the President's desk, unless the President asks the USTR, his Cabinet member, what are you doing on that particular case, I want to take it into——

Mr. Florio. Well, don't you think the USTR is going to consult with or—I don't want to say get clearance or approval——

Mr. Guarini. I'm sure that will happen. But what I'm saying is that at least we give him more authority to act without the President.

Mr. Florio. I see.

Mr. Guarini. So therefore, we try to depoliticize it. You will never fully depoliticize it, but you at least——

Mr. Florio. And you shouldn't.

Mr. Guarini. And you shouldn't because he should be responsible, the President. The President is indeed the leader and Chief Executive Officer of our country. But actually, it helps him somewhat because when he's talking with President Nakasone and a matter has come up, he certainly has a way out to say look, this is the way my USTR had handled it; I understand that there's a problem that's been created, let me look into it.

Whereas, the other way he says look, it's on your desk right now; I expect, if you're going to be able to have a good relationship with us and we continue the great friendship that we have, that you do this and such.

Mr. Florio. Let me just say that I think your explanation is very persuasive and meritorious, and I think there is some value in that it helps the process.

Mr. Guarini. Yes; it helps the President, in a sense. It gets him off the immediate hook and at the same time gives the man with his full attention span to trade to function and to coordinate our fragmented trade picture today.

Mr. Florio. My last point would be, again, how would you respond to the criticism that aspects of the bill, particularly the industry boards and things of that sort smack of industrial policy, and aren't we getting our foot into the door that before too long we're going to have a system that is at variance from our traditional system of economic nonmanagement in this country?

Mr. Guarini. I think that what we're talking about is developing strategy within our separate industries by having advisory boards work closer together, knowing the problems of their business. This is done in every civilized trading nation.

We are at odds with each other; government fights against labor and labor fights against management, and management fights against government, and we're chasing our tail. What we have to do is become partners; that we're all in this together, that a standard of living and a way of life for all Americans is tied into our cooperation with each other. We all have a stake in the process.

Mr. Florio. I agree with what you are saying, but I would just note the interesting changes in times, because some of us made those same arguments a couple of years ago, as recently as last year, and inevitably what came forward were the points that I tried to make.

Someone would say, "Well, you're starting us down the road to state planning." Industrial policy was the term that was being thrown out and being criticized. And it is just an interesting development that this year no one is launching those types of attacks on these proposals, notwithstanding the fact that essentially what you are saying is what was said a year ago, 2 years ago. But it's the changing times; perhaps it's the impending problems associated with the trade deficit that are more visible now that are causing people to appreciate the fact that the status quo of the last couple of years is unsatisfactory, and therefore we're going to have to shift in some way, and that in shifting in some way doesn't necessarily mean that you go to the extreme position of seven people sitting around a table, whacking up capital markets, and things of that sort.

So that somewhere there is a need for a greater coordination, a greater sense of interaction between the various parts of our economy—labor, business, management, and government—to coordinate, make more rational——

Mr. GUARINI. There can always be checks and balances, which our Government has been known to put into place.

I remember Benjamin Franklin said, "If we don't stand together, we will hang separately," to paraphrase that famous quotation.

We indeed have to work together as a team, and we're all in this together. And labor and industry and government have a stake in moving America forward.

Mr. FLORIO. Let me yield to Mr. Lent.

Mr. LENT. I thank you.

I just want to follow up a little bit on this point, which seems to be or could be a sticking point with respect to H.R. 1950, and that is what you have characterized as the depolitization of trade by shifting the administrative responsibility for making a decision on shoes or copper or motorcycles or whatever the particular product might be off the President's desk over to the desk of the USTR, who would be freed up from many of the foreign policy, war-and-peace implications and problems that the President is facing on a daily basis.

I suspect later on today when we hear from administration witnesses, that we're going to find, while they haven't taken any position on H.R. 1950, that they object to any transfer of the President's authority over to the USTR under the trade laws.

It has been suggested by some—and the gentleman mentioned checks and balances—that possibly a way out would be to provide in the legislation for a veto by the President over any action that the USTR might want to take.

Mr. GUARINI. I would subscribe to that.

Mr. LENT. What would the gentleman's attitude be to that.

Mr. GUARINI. I would subscribe to that. I think that we could write in any safeguards that we feel comfortable with. And certainly this does not really take away any power from the President. It just takes it away from his desk. He's got certainly enough to do in the toughest job in the whole world, to run the leading democratic nation of 240 million people, than to have ITC cases on his desk continuously.

I think that we are, in a sense, doing the President a great favor. And at the same time, he always has the right to take the case onto his desk. This is his Cabinet member. As he has the same control over Shultz at the State Department, he has the same control over the USTR man.

Mr. LENT. But as the law is written now, if he really has a shootout with his USTR, a real, solid difference of opinion between the administration and the USTR, short of firing the USTR——

Mr. GUARINI. Then he goes to Ireland.

Mr. LENT. And sending the person to Ireland, or perhaps Italy.

Mr. GUARINI. Find him another ambassadorship.

Mr. LENT. It might be well to have this check and balances veto power, so that short of firing the poor guy and making an ambassador out of him, we could have some final mechanism that the President could have.

Mr. GUARINI. I have no objection to that. I think it's a splendid idea.

Mr. LENT. As I understand it, the Labor/Industry Coalition for International Trade has gone on record saying that to remedy the U.S. trade deficit, action has to be taken not only as you have taken, to modernize U.S. trade laws, but also to address the U.S. budget deficit.

Mr. GUARINI. Our first and foremost consideration in America.

Mr. LENT. So you agree with that theory, that the deficit needs to be reduced.

Mr. GUARINI. It goes hand in hand. Actually it's all part of the fabric. I don't separate trade from deficit. If you bring the deficit down—and we've got to bring the deficit down—we have to face this session a $2 trillion debt ceiling argument on the floor of both Houses. That carries with it $147 billion of debt service, which makes it the third largest component of Government. After national security and Social Security, we have our debt service, and the way the budget reads in the outyears, we're talking in the next 5 years of having a $3 trillion deficit.

That's unthinkable. And that is what is causing our hard dollar, because we're importing $100 billion a year from overseas, so that we can keep running our Government, which dries up money in the market, forces up interest rates, and then the dollar gets overvalued. And when the dollar is overvalued, trade suffers.

Our dollar is some 30 to 40 percent overvalued, and that does not give us an opportunity of penetrating other trade markets. Even if we have free access, we have difficulty. So we must bring down our deficit, and we must bring down the value of the dollar.

Mr. LENT. And of course the other work your committee is facing with respect to so-called tax reform will have a tremendous impact—or could have a tremendous impact on the trade deficit.

I attended a breakfast the other morning where they had the chairmen of the board of a number of major American companies, and they said, if the trade deficit is such an important element, such an important concern of the Congress, even the President's Treasury-2 tax reform or the Rostenkowski, repealing, as they do, the ACRS system, the capital cost recovery system which was put in 1981, this is going to have a devastating effect on our trade deficit. And these chief executives indicated that if that happens, America will have the most expensive capital cost recovery problem of any industrialized nation.

Mr. GUARINI. Our tax system operates against us, Norm. Our tax system does not——

Mr. Lent. They're going to export jobs, build plants overseas, buy overseas.

Mr. Guarini. We are not—where we have VAT nations which can discount—and Japan can discount—we have a tax system that does not allow us the advantages that other trading partners have.

Mr. Lent. Well, the tax system we have now, the 1981 law, they seem to feel, has been very helpful.

Mr. Guarini. Well, that's because of tax credits and accelerated depreciation. And, of course, that is now being stretched out, both in the President's proposal as well as in the staff option.

Mr. Lent. And that stretchout, these chief executives maintain, will take what is sort of a middle-of-the-road capital cost recovery problem for American industry and make it the most expensive of any of their competitive nations.

Mr. Guarini. Our capital cost——

Mr. Lent. Thus resulting in the transfer of jobs overseas.

Mr. Guarini. Our capital costs us three times what capital costs an industry in Japan.

Mr. Lent. And then we aggravate it.

Mr. Guarini. And that would probably aggravate it.

Now I had breakfast with the U.S. Trade Representative this morning, Clayton Yeutter, and I asked him to, please, while we're going through tax reform, to give us the benefit of his thinking, because we need his input into the trade laws that we're talking about now and trade modernization, and he said in 2 or 3 days, he hopes to have some packages to your committee and to my committee concerning his positions and some suggestions and recommendations, and in regard to tax reform law, where it impacts on trade, he said that he would look into any suggestions that he may make from the President's proposal.

So these points you make are very, very valid and very, very timely.

Mr. Florio. Would the gentleman yield?

On just that point, just to get some clarification, isn't the rationale of the administration, as well as the Ways and Means Committee, for making some modifications in the tax credit provisions and accelerated depreciation concepts, that those concepts, as they have been implemented over the last number of years, have not resulted in the capital formation that they were supposed to, have not resulted in the revenue recovery that they were supposed to, and hence they have contributed to the deficit itself, which is, as you indicated, a basic problem in the trade area that we have.

So in a sense, there's an effort to balance the desirability of capital formation out of the Tax Code with the problems that have been associated with the implementation of those provisions, and that's why there is some suggestion about stretching out modification, and that we can't be looking at it exclusively from the standpoint of those individuals that Mr. Lent talked with the other day, who like the existing system for purposes of capital formation, as they understand it, who may not have a full awareness of the impact on the deficit, which we are all lamenting as well.

Mr. Guarini. I wish we could expense out items, instead of having accelerated depreciation, if we could afford something like that or phase into it.

Mr. **Lent**. Well, the point the chairman makes was brought up at this meeting, and the response that was given was, that, there has been a great deal of one company acquiring another company in order to take advantage of their writeoffs and their NOL's and so forth, and that could be something which was easily remedied by a simple amendment to the tax law.

But to redo the whole effort of 1981 and pull back from where we are now would be a mistake, and they said that the capital expansion has taken place. The jobs—we have more people working in America than ever before.

Mr. **Guarini**. Service industries.

Mr. **Lent**. And many of these plant expansions need more than 2 or 3 years on the drawing board, and they're in the works, but they're not going to go ahead with them if the cost of capital is going to be increased so dramatically as is planned in these proposed reforms.

Mr. **Guarini**. I'm very concerned about that, Norm, and trade should be one of the main components. We talk about fairness, simplicity, and economic growth, and by "economic growth," the entire proposal of the President means 1 percent of gross national product, a one-time shot, and we're churning up a lot of industries and changing the way of doing business and hurting some of our smokestack industries in this total tax revolution, if you will.

I happen to believe that taxes should be evolved, that there shouldn't be radical changes, that we should do it gradually over a period of years, and that we should have trade and national defense as part of our overall perspective.

Mr. **Lent**. The only point I'm trying to make with you and with my colleagues is that I think this is a good approach, this H.R. 1950. But we could negate it very quickly if we——

Mr. **Guarini**. If we take out the incentives.

Mr. **Lent**. I mean, that tax reform bill is known among American industrial leaders as the "Japan Tax Relief Act of 1985."

Mr. **Guarini**. Well, you know what it does, too, it takes $25 billion, adds taxes to the corporate sector, and gives it for the rate reductions for the individual sector, which means you are going to automatically raise the cost of products, because that gets passed on to the consumer. So that is a step in the wrong direction, and the tax credits and the accelerated depreciation, as you point out, could be a step in the wrong direction.

Mr. **Lent**. Well, that's true. An American union man who has lost his job to a Japanese worker or a worker in Hong Kong doesn't feel real good that his tax rate has dropped 3 points, if he doesn't have a job.

Mr. **Guarini**. That's correct. And we've got millions of people out of work, and particulary smokestack industries that are going to be hurt and targeted by the Tax Act, if it's as it's proposed.

However, I have good judgment in the leadership of the Ways and Means Committee and the members, bipartisan, in the Ways and Means Committee, that we will come up with a package that will take trade fully under consideration.

Mr. **Florio**. I would just note how we've come full circle. Democrats are arguing against consumer demand, motivated economic growth, and I suppose that is a commentary on the times.

Mr. **GUARINI**. Yes.

Mr. **FLORIO**. The gentleman from North Carolina.

Mr. **BROYHILL**. I thank the chairman for recognizing me at this time.

I will not be able to participate in these hearings this morning, as I had hoped, due to prior commitments and other committee meetings that will be taking place this morning. I do appreciate the testimony and especially the leadership of Mr. Guarini in this whole effort.

He has a good bill. It should be given consideration. It should be considered by the House, let the House work its will in this area.

There is no need to go over the whole record, but we do have a problem, and you've already stated the problem well.

I think that I would like to add to the record the problem that is facing the textile industry, which is the biggest industry in my State which is the situation for both the Carolinas.

We made some estimates the other day of what the impact of the import penetration into this U.S. market has made on the industrial base in our two Carolinas and found, to our shock and dismay—I knew it was bad, but didn't know it was quite this bad—that in the past 4 years, on the average, a textile plant is closed every 11 days. Every 11 days, a textile plant is closed, when you take into consideration all the plants that have been closed in the last 4 years.

Mr. **GUARINI**. And not only are you losing the income tax revenue from the people that would be otherwise productively working, but you also have social costs to our Government that become enormous.

Mr. **BROYHILL**. This is just one of the industries. We could name industry after industry.

Now the representative from the STR, Special Trade Representative's office is going to testify in a few minutes, saying, and I quote: "The President has indicated his willingness to work with Congress to improve legislation on the books."

I'm not going to be able to be here to take issue with that, but I must take issue with it. I have seen no willingness on the part of the administration to work with this member or any other member that have concerns along this line and try to come up with legislation to improve the situation.

We have tried. We've held meetings directly with the President, with the Trade Representative, the Secretaries of Departments, and all we get is a "circle the wagons" mentality.

Mr. **GUARINI**. Let's hope that will change, Jim.

Mr. **BROYHILL**. I hope that it will. And I do want to commend you for your bill. It is a good approach to the problem.

I go back home, and people say, "Well, why can't you put into the law that when imports get over a certain percentage, that you freeze those imports?"

Well, that sounds great and, you know, but it would be simplistic and so forth. You and I know that it would not be the answer, because to put an arbitrary number into the law would not work in every case, whereas your bill says that, on a case-by-case basis, if you make your case that there has been subsidies, that there has been dumping or targeting or the surging of imports in a particular category, a particular industry, if you can make your case, then you are going to get some relief.

Mr. GUARINI. Exactly.

Mr. BROYHILL. And it seems to me that that is the proper and the right approach.

So I want to commend you, and we're going to work with you on this legislation.

Mr. GUARINI. Thank you very much, Jim.

Mr. FLORIO. Mr. Coats.

Mr. COATS. I know that there is a vote on the floor, and I'll be very brief.

I echo a lot of the sentiments of my leader here, Mr. Broyhill, and I want to commend you for putting some very serious effort and study into an approach that I think gets to the problem. I appreciate your willingness to be flexible in terms of the discretionary authority of the President.

I think there are national security concerns and things to which we need to be sensitive. On the other hand, the current laws either are not drafted properly, or they're not being enforced properly.

Mr. GUARINI. Or are out of date.

Mr. COATS. Definitely there are areas where perhaps in both instances we can make some needed reforms, and I appreciate your work on this and hope to work with you and members of this committee in fashioning a remedy that is appropriate for the problems that we face.

Mr. GUARINI. I appreciate your help.

Mr. FLORIO. Thank you very much.

We have approximately 6 minutes before there is a vote.

We appreciate your participation and look forward to working with you.

Mr. COATS. Thank you for your courtesy. Thank you, Jim.

Mr. FLORIO. The subcommittee will stand in recess for approximately 10 minutes.

[Brief recess.]

Mr. FLORIO. The subcommittee will kindly reconvene.

We are very pleased to have as our next witness Mr. Geza Feketekuty, special counsel to the Trade Representative, Office of the Trade Representative.

We are pleased to have you back before us as a witness and are pleased to hear from you at this point.

STATEMENT OF GEZA FEKETEKUTY, SPECIAL COUNSEL TO THE TRADE REPRESENTATIVE, OFFICE OF THE U.S. TRADE REPRESENTATIVE, EXECUTIVE OFFICE OF THE PRESIDENT

Mr. FEKETEKUTY. Thank you, Mr. Chairman. It is always a pleasure to be with you and participate, in this case, in your deliberations on H.R. 1950.

As you have indicated earlier, the President has offered to work with the Congress in drafting the appropriate legislation, and Mr. Broyhill's comments notwithstanding, he means it. As the President likes to say from time to time, try me. I would say that is an appropriate comment in this case.

Mr. FLORIO. Can we expect something before too long, then?

Mr. **Feketekuty**. Certainly. I think, as Mr. Guarini said this morning, my boss Clayton Yeutter has indicated that there will be some suggestions forthcoming, but we don't really want to make this a one-way process; we want to make this a two-way dialogue, and working with the Congress means working with you.

Mr. **Florio**. In a sense, Mr. Guarini and others have floated something out, and working with entails now, I would think, a counter response in some tangible form.

Mr. **Feketekuty**. Right. Well, we will be sending you various suggestions, and we will also be giving you a concrete response on H.R. 1950. The intention is to present it within the next 2 weeks.

Mr. **Florio**. Good. That is very helpful.

Mr. **Feketekuty**. Unfortunately, we don't have a position yet, so I am somewhat constrained in my testimony this morning, particularly with respect to the individual provisions of H.R. 1950, but we have taken a position on a number of issues addressed in H.R. 1950, and certainly we can discuss that.

The President laid out a trade action program in his speech on September 23. In addition to that, administration witnesses have appeared before a number of committees, including, in your case—what was it, Tuesday—on the telecomm bill, so there is at least a foundation of administration views on the broad range of legislation. The President's offer was genuinely meant, and it covers not only issues in which the administration has developed some ideas but where the Congress has ideas, and we are prepared to sit down and see what kinds of provisions could be drafted that are mutually acceptable to the Congress and the administration, provisions that solve the basic problems that have been identified.

The Congress has in many cases put its finger on important problems and these issues need to be addressed.

In terms of the discussion this morning, I would like to organize my comments by three different areas. One is the President's Trade Action Program that addresses the fair trade issue, which is central to many of the bills pending before the Congress and certainly central to H.R. 1950.

Second, I would like to talk a little bit more about some of the legislative ideas that the President has indicated he is interested in, and thirdly, I would like to talk briefly about the new GATT round that Mr. Guarini mentioned earlier this morning.

Now, with respect to the Trade Action Program, you know, I am sure, that the President directed the United States Trade Representative, Clayton Yeutter, a couple weeks ago to self-initiate five 301 cases, on Japanese leather and leather footwear, canned fruit barriers in the European Community, Korean insurance policy barriers, Brazil's import restrictions in the area of informatics, and Japanese tobacco restrictions.

As I am sure you are aware, this is the first time that the administration or any administration has self-initiated action under 301, this is indicative of a reinforced resolve to deal with unfair trade practices.

The administration is now reviewing a range of other issues, and you can expect in the weeks ahead further announcements from the administration with respect to new actions that it will take in other cases.

The President has also directed the Secretary of Commerce, Mr. Baldrige, to establish a strike force which is to identify other unfair foreign trade practices and to determine what we need to do in order to deal with them. Mr. Baldridge will be following up on that.

The President has also indicated that he wants to do more in meeting unfair competition with respect to foreign export credits, particularly with respect to mixed credits, and as you know, he has indicated that he will propose to the Congress a $300 million war chest which would enable us to provide up to $1 billion worth of mixed credits when that is necessary to deal with unfair competition by others.

The ultimate objective of the war chest is to persuade others to sit down with us and negotiate the elimination of these unfair practices.

Another area which has been of concern for some time to the administration as well as to the Congress has been the problems in our trade with Japan. As you know, we have had so-called MOSS talks with Japan, which have yielded some results but not enough to satisfy us. The President has indicated that he is willing to wait until January 1 to get adequate results. If that is not forthcoming, he is prepared to take further actions.

In the meantime, Secretary Shultz and Foreign Minister Abe have met and they have agreed to work towards the end of the year deadline.

I also want to mention something about foreign industrial targetting. As you know, the Congress requested that we look into that issue, and we have sent the Congress a report. It is a very difficult area, but we are pursuing this actively, and we certainly will be looking into what we can do in order to deal more effectively with such patterns of behavior.

Those are a number of steps that have been taken, but over and above these steps, there is a new resolve to face up to issues that have been around for a long time but that we have not been able to resolve. We are going to push them to resolution, and if not, we will defend our interests as necessary.

Mr. **Florio**. What do you think prompts this new resolve?

Mr. **Feketekuty**. Well, the administration has heard from the American people and the Congress that in light of this very large trade deficit, we can no longer afford to be patient, that we have to be a little impatient, and that we have to press our trading partners to take this more seriously. I think that they will respond.

Now, if I could turn to the second area of my testimony, which is the legislation. As I said earlier, the President has offered to work with you and has indicated a number of areas where he thinks reform of domestic laws would be useful. One of these is the intellectual property area, which is becoming of growing importance to our industries.

Our strength in the international marketplace is based upon our technology—that is the intellectual property—embodied in our goods, and it is important that we be able to defend those rights in the international marketplace. In my testimony I lay out some of the specifics. I'm not sure I necessarily want to go over that right now.

I have already mentioned that we will need from the Congress authority to establish a $300 million war chest—grant funds—for mixed aid credits. The administration also supports the clarification of the accounting provisions and liabilities of foreign agents under the Foreign Corrupt Practices Act of 1977 and favors allowing U.S. companies to export new drugs and biologicals not yet approved by the Food and Drug Administration to countries where they can be lawfully sold.

We think these are useful changes that can be made in order to reduce domestic disincentives to our exports.

We also believe that some changes in the trade laws are needed with respect to nonmarket economy countries. We have had, I think, some real frustrations in how to apply our various unfair trade laws to these countries, and we have come up with some suggestions on how that can be improved, particularly with respect to the antidumping laws.

The administration also favors a number of other technical amendments to section 301, section 201, and the antidumping and countervailing duty laws. We are pleased to see the establishment of time limits for the conclusion of dispute settlement procedures under section 301. With respect to 201, we would like to see a fast track procedure for perishable agricultural items.

We also would like to see that the laws reflect the growing consensus that the ITC, in looking at 201 cases, should consider plans being made by industry to deal with its adjustment problems; in other words, to look at the adjustment intentions of U.S. industry.

I would also like to note that witnesses have appeared before your committee early this week on the telecommunications bill, and I noted that you have marked it up. We continue to be concerned about a number of general and specific features of the bill that makes it unacceptable as currently drafted.

Mr. FLORIO. You say it makes it unacceptable?

Mr. FEKETEKUTY. As currently drafted. In particular we are concerned about the mandatory retaliation provision of the bill—and I think that will come as no news to you—the lack of sufficient negotiating authority, the possibility that the bill might force the President to take actions that are inconsistent with U.S. international obligations, and the use of the FTC, a domestic regulatory agency, as an instrument of U.S. trade policy.

Mr. FLORIO. The only reason I interrupted you was that your statement about making it unacceptable is a bit stronger than the testimony we had just 2 days ago from the USTR and the Department of Commerce, which said they had no position on the bill and that the concept was a fine one they could identify with. But you appear to be shifting a bit by saying that it is unacceptable, which connotes that there is a position that there is no support for the bill.

Mr. FEKETEKUTY. I would say that we are willing to work with you in coming up with provisions that are acceptable to us, but as currently drafted, it is not acceptable to the administration.

Now, the third part of my testimony focuses on the new round of trade negotiations. I think we feel that many of the problems that our businesses have abroad are the result of inadequate international trade laws and international trade rules. We think that this needs to be remedied through a new round of trade negotiations.

We therefore look forward to the Congress giving us support and giving us the authority to proceed with such negotiations. We noted that H.R. 1950 includes authorities in this area, which we certainly favor.

I should also indicate that the President continues to be interested in pursuing other options for international negotiations besides a new round of multilateral trade negotiations. As we have indicated to the Congress, the Canadian Prime Minister has offered to explore broad-based trade negotiations between our two countries, and we have begun discussions with the Senate Finance Committee and the House Ways and Means Committee and the private sector on the desirability and objectives of such negotiations.

We continue to be open minded to the possibility of other negotiations, though we don't have anything in mind at this point.

Now, as I said earlier, we look forward to working with the Congress to put in place necessary legislation that will promote free and fair trade. Although the Trade Policy Action plan identifies a number of areas where legislative reform is needed, the administration welcomes the suggestions of the members of Congress on other potential legislation that has as its objective the promotion of free and fair trade, and will work with you to see that good legislation is passed.

Conversely, the administration will strongly oppose any measure that it believes is protectionist and will harm economic growth, cause the loss of jobs and diminish international trade.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Feketekuty follows:]

TESTIMONY ON U.S. TRADE POLICY IN CONNECTION WITH HEARINGS ON H.R. 1950, THE TRADE LAW MODERNIZATION ACT OF 1985

by

GEZA FEKETEKUTY
Counselor to the U.S. Trade Representative

Before the Subcommittee on
Commerce, Transportation and Tourism

October 3, 1985

Mr. Chairman and members of the Subcommittee, as the Counselor to the U.S. Trade Representative I am pleased to participate in your deliberations on trade legislation. The Administration has not taken a position on the legislation proposed in H.R. 1950, the "Trade Modernization Act of 1985," which I understand is the focus of your present deliberations. I therefore cannot comment on specific provisions of H.R. 1950. The Administration, however, does intend to provide the Subcommittee with its views at a future date. As the President has said, we intend to work with the Congress to craft trade legislation that is acceptable to both Congress and the Administration.

A central objective of many legislative proposals pending before Congress is the achievement of fair trade. The President agrees with that central objective. It was the major message in his speech last Monday, September 23. Over the last few weeks actions taken by the Administration have reinforced that policy view. I think it might be useful for this committee if I were to spell out the Administration's policy in greater detail.

The President has also indicated his willingness to work with Congress to improve legislation on the books. In his speech, and in the accompanying fact sheet, the Administration identified a number of areas where legislative reform might be useful. In my testimony, I would like to draw the Subcommittee's attention to these areas. The Administration has also been working with the Congress in seeking to develop appropriate legislative solutions in other problem areas identified by Congress, such as the telecommunications trade. In general, the Administration is willing to look at a broad range of problems, provided it does not lead to protectionist solutions.

Another element of the President's program to achieve free and fair trade concerns new multilateral negotiations in the GATT. The GATT rules, which define common standards of fairness for the international trading system, are in need of repair. Congress should support such a negotiation effort.

The Administration's Trade Policy Program

The President's trade policy is based on several principles, the foremost of which is the promotion of free and fair trade. The

President firmly believes that free and fair trade is in the best interest of the citizens of the United States. Such a policy produces more jobs, improves the use of our nation's resources, promotes more rapid growth and innovation, and ensures a higher standard of living for Americans. Free and fair trade also advances our national security interests by strengthening the economic and political systems of our allies.

The President's Trade Policy Action Plan maps out the Administrations plan for making free trade fair trade. It is comprised of a number of Administrative actions that are designed to translate the free and fair trade principle into policy. Furthermore, it identifies a number of legislative improvements that the Administration believes would be useful and would like to work with Congress to draft necessary legislation.

I would like to remind the Subcommittee that the Administration's statement on international trade policy also makes clear that the challenges confronting the U.S. and world trading system are not just trade related. There are also macroeconomic factors that have contributed to an imbalance in world economic performance. As a result, the elements of the Administration's trade strategy are the promotion of more open and fair conditions for U.S. trade and the maintenance of a strong and growing international economy.

Administrative Actions Taken

Many of the legislative proposals pending before Congress focus on concerns about the administration of policy. I believe the Administration's strategy for trade policy should meet many of these concerns. Let me review some of the Administrative directives contained in the President's trade policy.

Like the Members of Congress, the President is determined to attack unfair trade practices. The President's commitment to free and fair trade was demonstrated in a recent radio address when he directed the U.S. Trade Representative to initiate or accelerate the unfair practice proceedings on five cases--Japanese leather and leather footwear import restrictions, European Community canned fruit barriers, Korean insurance policy barriers, Brazil's import restrictions on micro-electronic products, and Japanese tobacco restrictions. This is the first time, as I'm sure most of you are aware by now, that the U.S. Government has ever self-initiated Section 301 actions. The Administration intends to continue to investigate unfair trade practices and, where appropriate, act to eliminate these unfair practices.

The Administration will also accelerate its efforts to address the problem of foreign government financial assistance to exports, particularly where mixed credits are involved. The President has proposed that Congress approve a $300 million appropriation for grant funds to support up to $1 billion in mixed credit loans to targeted buyers. This program is designed to enable U.S. exports to compete effectively in third-country markets until we can eliminate predatory mixed credit competition through negotiations.

The President has directed the U.S. Trade Representative to initiate and accelerate both bilateral and multilateral negotiations with countries where counterfeiting or piracy of U.S. goods has occurred to bring these practices to a quick end. The Administration will increase its efforts to protect intellectual property rights, with a view toward possible legislative or Administrative initiatives.

The President has directed that a strike force be established among the relevant agencies of our government, with the task of identifying unfair foreign trade practices used against us and executing the actions necessary to promptly counter and eliminate these unfair practices.

The United States will continue market-oriented sector selective (MOSS) discussions with Japan. However, the President has directed the Secretary of States to seek time limits on existing sector discussions with Japan, at the end of which specific commitments will be evaluated and follow-up procedures begun.

New sectors will be added that offer the promise of expanded U.S. exports.

The Administration supports the market-opening objectives of equitable access legislation but will oppose legislation that would require the President to close U.S. markets on the basis of sectoral reciprocity. The proper approach is to give the Administration authority to negotiate foreign barrier reductions.

The Administration also intends to follow up on its reports to the Congress on the subject of foreign industrial targeting by continuing to examine the potential problems created by foreign targeting and, where appropriate, possible remedies.

Although the Administration is committed to market-based solutions to trade problems, at home and abroad, occasional exceptions may be necessary. In particular, it is recognized internationally that nations may occasionally find it necessary to temporarily safeguard industry from serious harm caused by a surge in imports. The President has directed that any safeguard action taken by the United States will be transparent, temporary, time specific, decline over the period of relief, and offer the prospect of adjustment on the part of the U.S. industry so that it will be competitive after the relief is terminated. Moreover, the Administration reserves the right to respond to economic conditions internationally and to levels of import penetration that threaten domestic industries essential to long term national security.

Legislative Initiatives Supported by the Administration

U.S. trade laws are in want of much improvement. The President's Trade Policy Action Plan identifies a number of areas where the Administration seeks to work with Congress to draft necessary legislation that will promote free and fair trade and secure more jobs for American workers. This includes legislation to further protect intellectual property rights, increase export promotion, provide trade remedies for imports from nonmarket economies, and make technical amendments to U.S. trade laws. I would like to elaborate in more detail on some of these legislative initiatives.

To further protect intellectual property rights, the Administration supports the amendment of U.S. copyright laws to protect against trade in articles that infringe U.S. process patents, extend the patent life for agricultural chemicals, eliminate Freedom of Information Act abuses by giving affected companies notice and an opportunity to oppose release of their business confidential information, and to clarify the protection of "firmware".

The Administration supports legislative initiatives that would promote U.S. exports through authorization and appropriation of approximately $300 million in grant funds, to enable the Administration to offer $1 billion in mixed credit loans to targeted buyers. In addition, the Administration supports the clarification of the accounting provisions and liabilities of foreign agents under the Foreign Corrupt Practices Act of 1977, and favors allowing U.S. companies to export new drugs and biologicals not yet approved by the Food and Drug Administration to countries where they can be lawfully sold.

The unfair trade laws do not work with respect to nonmarket economy countries. The Administration has long felt that our antidumping and countervailing duty laws should be strengthened so that a predictable pricing test covers nonmarket economies, thus enabling our companies to have protection against unfair dumping from those countries. Furthermore, these laws should be improved so that business can have full and rapid protection in receiving help against unfair imports.

The Administration supports several technical amendments to U.S. trade laws. In particular, a time limit should be placed on Section 301 dispute settlement and a fast track procedure should be established for perishable agricultural items. We should no longer tolerate 16-year cases and settlements so costly and time consuming that any assistance is ineffective. In addition, the antidumping and countervailing duty laws could be strengthened by a number of specific amendments.

The Administration notes that H.R. 3131, the Telecommunications Trade Act of 1985, was marked up by this Subcommittee yesterday. As was noted in the Administration's testimony earlier this week, the Administration supports the market opening objective of H.R. 3131, but is concerned about a number of general and specific features of the bill that make it unacceptable as currently drafted. In particular, we are concerned about the mandatory retaliation provision of the bill, the lack of sufficient negotiating authority, the possibility that the bill might force the President to take actions that are inconsistent with U.S. international obligations, and the use of the FCC, a regulatory agency, as an instrument of U.S. trade policy. Nonetheless, the Administration would not oppose telecommunications legislation in the Congress if such legislation could be structured in such a way as to deal with these and several other concerns that we have in this area.

The legislative proposals supportive of the President's Trade Policy Action Plan would be incomplete without the authority to support our trade negotiating initiatives. To have a successful new round of multilateral trade negotiations, we will need legislation that, to the maximum extent feasible:

- sets out negotiating authority and objectives,
- enhances the President's leverage to achieve those objectives, and

- offers maximum prospects for Congressional approval as necessary to implement the results of the negotiations.

In addition, the President is prepared to explore regional and bilateral agreements that would promote more open trade and serve U.S. economic interests. One such possibility is through the negotiation of bilateral free-trade arrangements such as the one recently concluded with Israel. As the Subcommittee is probably aware, Canadian Prime Minister Mulroney has recently offered to explore broad based trade negotiations between our two countries. The Administration has begun discussions with the Senate Finance and House Ways and Means Committees and our private sector on the desirability and objectives of such a bilateral negotiation.

Where We Go From Here

The Administration looks forward to working with Congress to put into place the necessary legislation that will promote free and fair trade. Although the Trade Policy Action Plan identifies a number of areas where legislative reform is needed, the Administration welcomes the suggestions of the Members of Congress on other potential legislation that has as its objective the promotion of free and fair trade, and will work with them to see that good legislation is passed. Conversely, the Administration will strongly oppose any measure that it believes is protectionist and will harm economic growth, cause a loss of jobs, and diminish international trade.

Mr. **Florio**. Thank you very much.

Just to make it clear, did I understand you to say that within a period of a few weeks, that we can expect some proposals from the administration to give us its thoughts on some changes—I think you mentioned specifically 201, 301 language—that we might be able to incorporate into this type of legislation?

Mr. **Feketekuty**. Yes, sir.

Mr. **Florio**. Thank you.

In the President's Trade Policy Statement of last week or the week before last, many of us found much that is meritorious in it. The whole concept of the war chest is a meritorious one, but it is not new. The idea of a task force to have governmental people do what they are supposed to have been doing in the first place, which is to evaluate unfair trade practices against American industries as an ongoing responsibility under the existing law. The call for direct intervention has been one that lots of people have been making for a long period of time.

So, meritorious as it may be, it is not anything that is new. I suppose my question is: What is it that the President feels is something that may very well be new that will address the current crisis that we have in trade that has resulted in the deficit? Can you make any suggestions about anything that he has either said or has contemplated that is being offered to us that is going to make a substantial dent in the trade surplus that we have in the relative short term?

I realize this can't be changed overnight, but there are arguments that have been raised that we can't tolerate the continuation of this situation for timeframes in the period of years. Do you have any suggestions as to something that some of us have missed in the President's proposal or something he has in mind that is going to make a substantial change in the outcomes that we have experienced in the last year or so in trade deficits?

Mr. **Feketekuty**. I would distinguish action taken to deal with longstanding concerns about unfair practices, from the impact all this would have on the actual magnitude and size of the trade deficit. Now, I think that it has been said many times that even if foreigners eliminate all the foreign unfair trade practices, it would make only a very small dent in the magnitude of the trade deficit as such; that the trade deficit is largely the function of macroeconomic forces everything from the debt crisis in Latin America, slower growth in the rest of the world, and the high value of the dollar resulting from capital inflows. You know all of that and there is no need to go through it.

But clearly, macroeconomic factors account for most of our deficit. But what we are trying to do is to make sure, and to assure the American people, that there aren't any unfair trade practices that worsen our situation.

Mr. **Florio**. So you subscribe to the other witnesses' testimony that we really are just dealing at the margins with our overall trade problems when we deal with this type of legislation.

The other day we had a hearing on telecommunications trade problems. Witnesses came in and said, yes, there are unfair trading practices. We don't have market access. But the total Japanese telecommunications market is $4 billion, and therefore, to think that somehow by opening up those markets for United States producers of goods and services in telecommunications, that you are going to make any real dent in reducing the trade deficit is just not realistic.

Do you subscribe to that?

Mr. **Feketekuty**. I certainly agree with that, yes, sir.

Mr. **Florio**. Well, what was particularly troubling, and we will ask some of our other witnesses, particularly our labor witnesses today, in the field of telecommunications the other day was to hear domestic producers stating that even if we dealt with our market access problems overseas and even if we dealt with the currency imbalance problems, there would still be a substantial need to become more productive, and they translated that into reduced employment levels here in the United States.

So those who hold out the prospect that we can stabilize employment in this, our most productive industry, telecommunications, much less some of the other industries that are regarded as not being competitive, through trade legislation, whether it be sectoral legislation in telecommunications or more generic legislation such as this, would you say that is something we can expect, that we can expect continuation of job losses in some of those fields, notwithstanding what we do in opening other markets or even stabilizing the dollar?

Mr. **Feketekuty**. I would say that there are tremendous opportunities with new technologies as well. We may well find that we need fewer workers to produce certain types of equipment, but the new equipment itself will need to be produced, and this will create new jobs.

So I'm not sure that the conclusion is that we won't be able to have enough jobs for everybody. It may well be, however, that some people are going to have to change where they work. There is a constant pressure for change in our economy, particularly given the rapid pace of technological change today.

Mr. **Florio**. That is an interesting point. Let me just address it in the context of something I thought you said. I think you were talking about the 201 provisions particularly, the administration's hopes that there would be plans by industry to deal with the problems that had prompted the 201 action, again coming back to the shoe example, where the shoe industry has demonstrated that it is injured substantially by foreign trade and yet the administration did not see fit to exercise discretion to take any remedial action to deal with that industry.

Are you saying that you expect the shoe industry to come forward and express what actions it feels it should take to make it more productive, and it would be only on those conditions being imposed that relief would be provided under 201?

Mr. **Feketekuty**. I wouldn't say that those would be the only conditions, but certainly that they should weigh in the decisionmaking process.

Mr. **Florio**. Isn't there an argument that could be made that the administration or any administration could and maybe even should be required to condition import relief on an industry achieving of certain productivity goals—that there are public policy justifications for the administration taking the responsibility for putting relief and productivity conditions together rather than leaving it to the industry that certainly has cross-purpose goals to be achieved?

Can we anticipate the administration coming forward with requests for more authority for it to impose industry-wide conditions for increases in productivity, increases in competitiveness to be achieved prior to 201 relief being granted?

Mr. **Feketekuty.** I doubt that very much. I think there is a real problem. Here you get into the difficult area of industrial policy. If you have the Government imposing conditions like that, you start transgressing on the dividing line between what is appropriate activity for the private sector and what is appropriate for the Government.

But I would like to make a distinction between that and plans made by individual companies to improve their productivity, to improve their competitiveness.

Mr. **Florio.** But realistically can you expect the shoe industry to come forward asking for relief under 201, saying that we will also take all of these actions which will impact adversely on us as a means of getting quotas lifted?

Mr. **Feketekuty.** It shouldn't be in terms of taking action that will impact them adversely. It should be actions that will help them.

Mr. **Florio.** But I mean is it realistic to try to get the industry to agree that some people in the industry should go out of business in order to go into minimills, for example.

Mr. **Feketekuty.** I don't think that is realistic, no.

Mr. **Florio.** Then we are really saying if the administration is not going to talk about public policy conditions that it formulates, we are going to say that it is not realistic for the industry to impose those types of limitations on themselves to become more competitive. We are saying nothing is going to happen, which is exactly what has happened in the last number of years, and we are saying we are signing on to the status quo, which, as you have indicated, the public and the Congress don't feel comfortable with.

Therefore you come to a view that some have—and perhaps it is too cynical—that the administration is talking a good game about all of these things but is really trying to defuse the public opinion that is forcing reactions or maybe overreactions in the Congress. The status quo, the reliance on marketplace forces internationally is still the basic philosphic goal but the administration feels the need to cosmetically appear to be doing something when they really haven't got an interest in dramatically changing what it is that we are doing now.

Is that too unkind?

Mr. **Feketekuty.** I think it is. I think you are mixing two issues—doing something about unfair trade interfering with the market process. The administration certainly believes that our economy is a market economy and that is its strength, and that we should not depart from the basic model of a market economy. But it is consistent with that view to say that we should be extremely vigorous and aggressive in assuring that competition takes place on the basis of fair competition.

Mr. **Florio.** Let me just conclude and then yield to the gentleman, just by making the observation that I think that where we run into problems is in the international trade market. We are working from the assumption that the marketplace forces will play out, and not everyone is working from that assumption; that the concept of targeting around the world is one that is almost accepted as a basic imperative of national interest; that one wants to promote an industry, most other nations regard that as just common sense to enhance domestic economic well-being.

We work from the opposite premise, and accordingly, we are out of step with many other nations. I think when you talk about public opinion formulating, public opinion is formulating in a way to say that we have been talking about trying to change all those other folks around the world to our way of thinking, that it hasn't worked, and therefore maybe we ought to adopt some of their approaches so that there is the level playing field that we all talk about. More aggressive Government involvement in spelling out economic policy goals is something that we should do in the way that everyone else does.

Is that a fair analysis of the options of attempting to induce other people to operate as we do, from a basic perception of marketplace forces carrying the day versus the perception that we are not going to be successful in doing that, and therefore we ought to become a little more involved in having governmental involvement in marshaling resources for better economic health in the Nation.

Mr. **Feketekuty**. Well, there is a third option, and that is having some basic rules that arbitrate between the two kinds of economies. I mean you cannot expect everybody to manage their economies in the same way, so what you need is some rules that define some mutually acceptable forms of behavior, and that is what we are trying to accomplish through the GATT and continuing negotiations in the GATT.

I don't think any one country will say, we will give up the way we do things in exchange for the way you do things, but it is clear that there has got to be some basic fairness in international market competition.

Mr. **Florio**. My only observation is that that is true and we all subscribe to that. The difficulty is we have been trying that. We all, at least, have been paying lip service to trying to achieve that for the last couple of years, and there hasn't been a whole lot of success as our entire industrial economy is starting to deteriorate rather substantially.

If we are going to emphasize GATT discussions, the high-productivity parts of our economy, the service industries are starting to run into the same problems that our industrial or manufacturing industries have run into in the last couple of years, and as recently as just the last couple of days, we see no inclination on the part of many of our GATT trading partners to even address service industry problems.

How is it that we hold out the prospect that that is going to take place without some unilateral action on our part to force—and the nature of the forcing action, of course, is open to negotiation——

Mr. **Feketekuty**. That is really the question: what is the nature of the forcing action?

Mr. **Florio**. Thank you very much.

Mr. FEKETEKUTY. But let me just go back and say we clearly have some problems on our trade side, but we haven't done all that badly. There has been a lot of discussion about the number of jobs we have created. We are still looked at by a large part of the world as one of the more dynamic economies in the world. So we shouldn't downplay the strength of our competitive system.

I grant you that there are problems in how we relate to other people who have a great deal more Government intervention than we do, but at the same time, we should be willing to believe what we say, which is that our open market economy is a strong point.

Mr. FLORIO. Thank you very much.

Mr. Lent.

Mr. LENT. Thank you, Mr. Chairman.

I want to thank the witness, also.

Under the terms of the Trade Act of 1984, the STR is obliged to produce a report documenting unfair trade barriers overseas, and it is my understanding that that report is due next month, or rather this month, October 1985.

Can you tell us what the status of that STR's report is?

Mr. FEKETEKUTY. It is circulating in draft form among the agencies of the Government.

Mr. LENT. Can you tell us when it will be ready, when it will be released to the Congress?

Mr. FEKETEKUTY. I'm afraid I can't, but I can certainly inform you it should be imminent.

Mr. LENT. Have you seen the draft that is being circulated?

Mr. FEKETEKUTY. Oh, yes, sir.

Mr. LENT. Can you tell us what the preliminary conclusions of that report are?

Mr. FEKETEKUTY. It is encyclopedic. It doesn't draw general conclusions. What it lays out is a full listing of unfair trade practices and the estimated impact of those unfair trade practices.

Mr. LENT. Well, one of the conclusions is that there are many barriers out there; is that not correct?

Mr. FEKETEKUTY. That is correct.

Mr. LENT. And how are those barriers to be addressed? Is that covered by the report?

Mr. FEKETEKUTY. It addresses them individually, yes, sir.

Mr. LENT. Does it indicate that they have to be addressed through negotiations?

Mr. FEKETEKUTY. It indicates in many areas that negotiation is appropriate, but also that it may be necessary for us to take other action.

Mr. LENT. And what sort of action would that be? Give me a couple of forinstances.

Mr. FEKETEKUTY. Well, hitting somebody over the head.

Mr. LENT. Other than that?

Mr. FEKETEKUTY. I don't have it with me, so I can't really go into details with you, but it does indicate that there are limits to negotiations. There are times when we have to take actions into our own hands.

Mr. LENT. Just turning to another issue, the Trade Act of 1984 required that the STR take certain steps to implement the general system of preference status, that that might be revoked with respect to certain foreign nations if those nations failed to take adequate steps to stop counterfeiting and to stop intellectual property fraud.

Can you tell us what steps the STR has taken with respect to that provision of the 1984 law?

Mr. **Feketekuty**. We have initiated consultations with a number of countries with respect to identifiable practices, and that process is still underway.

Mr. **Lent**. I assume Taiwan would be one of the countries that consultations have been taking place with.

Mr. **Feketekuty**. I can't tell you for sure.

Mr. **Lent**. Can you tell us the names of any other nations other than Taiwan that——

Mr. **Feketekuty**. I think certainly Brazil, Mexico, Korea, and I assume Taiwan, but as you realize, our relations with Taiwan are sensitive, so I don't know how those discussions have been carried out.

Mr. **Lent**. Well, are there any accomplishments that can be pointed to as a result of those negotiations or consultations?

Mr. **Feketekuty**. I think the results will become apparent when we get to the deadline for making those decisions on GSP, which is——

Mr. **Lent**. When would that deadline be?

Mr. **Feketekuty**. I think it is early next year.

Mr. **Lent**. Will the STR be advised by you as its attorney to revoke GSP status if any nation fails to move adequately in the counterfeiting and the intellectual property fraud areas?

Mr. **Feketekuty**. I'm not an attorney, but yes, I would certainly advise that.

Mr. **Lent**. I have no further questions.

Mr. **Florio**. The gentleman from Colorado.

Mr. **Schaefer**. Thank you, Mr. Chairman.

Mr. Feketekuty—how do you pronounce that name?

Mr. **Feketekuty**. Feketekuty.

Mr. **Schaefer**. There are a couple of big problems that many industries have mentioned to me. One is the subsidy issue. As you know, many foreign countries do provide for their individual manufacturers as well as agricultural producers and the other is the relief from the so-called dumping practices of foreign manufacturers.

Would the President's new trade policy help U.S. manufacturers in these two areas?

Mr. **Feketekuty**. Those laws have been administered in a fairly objective technical manner by the Commerce Department. I can't see how the President's program would change that since presumably that has been a fairly legal, straightforward process. To the extent that the President has identified a number of areas where technical amendments in the countervailing duty and antidumping laws would be useful, that certainly could improve the administration of those laws.

Mr. **Schaefer**. So you believe we are headed in the right direction.

Do we need a trade bill and if we do, what should it entail?

Mr. **Feketekuty**. The President has said that a number of legislative reforms would be useful, so I think the answer from the administration is yes, legislation would be useful.

The President also laid out a number of areas where he thought legislation would be desirable. One is the intellectual property area. Another involves, as I just mentioned, some technical amendments to our antidumping and countervailing duty laws, and section 301, the unfair trade practices provision of the 1974 Trade Act. He has indicated that he would like the Congress to establish a $300 million fund.

Mr. **Schaefer**. What would the technical amendments do that you are talking about?

Mr. **Feketekuty**. The technical amendments would deal with, for example, the trade with nonmarket economy countries and address some other issues that, frankly, I can't answer.

Mr. **Schaefer**. Are we going to get these proposals?

Mr. **Feketekuty**. Yes, sir.

Mr. **Schaefer**. When?

Mr. **Feketekuty**. Over the next few weeks.

Mr. **Florio**. Will the gentleman yield?

Mr. **Schaefer**. Yes.

Mr. **Florio**. The types of technical amendments that you are talking about, would it be something like the upstream dumping questions of the Japanese, where undervalued steel is sold to the Koreans, the Koreans use it for oil rigs and then sell that to the United States? Would there not be the opportunity to look at the upstream steel subsidy in the finished oil rig product?

Is that the type of technical——

Mr. **Feketekuty**. I don't think that specific issue has been addressed in these technical amendments, although certainly we would agree that you have identified some problems that we need to work on.

Mr. **Florio**. I'm not sure I understood the answer. What is the nature of the situation dealing with countervailing duties and dumping, if it's not that type of thing?

Mr. **Feketekuty**. Frankly, I just don't know right now.

Mr. **Florio**. OK. I thank the gentleman.

Mr. **Feketekuty**. I do know about the amendments with respect to the nonmarket economy countries in changing the way subsidies are calculated—I mean, dumping margins and subsidies are calculated with respect to the nonmarket economy countries.

Mr. **Schaefer**. Mr. Chairman, I would really appreciate getting this information as soon as we possibly can.

Mr. **Florio**. Mr. Schaefer, I think before you got here, it was stated that within the next 2 or 3 weeks, we will have the proposal, and we will certainly share them with everyone when the subcommittee receives them.

Mr. **Schaefer**. One final thing. Dumping and subsidies are two major concerns that I have. Can we expect to see these issues addressed in whatsoever vehicle comes before the subcommittee?

Mr. **Feketekuty**. Right. I understand, sir.

I am afraid I'm just not a technical expert on those specific provisions, and I didn't come prepared to answer them. But I did want to indicate that there are some technical amendments that we will propose, and undoubtedly, if Congress has other suggestions, that we're prepared to sit down and work through them.

Mr. **Schaefer**. Thank you, Mr. Chairman.

Mr. **Florio**. Mr. Tauke.

Mr. **Tauke**. Thank you, Mr. Chairman.

I welcome you to the subcommittee. I think you're getting off pretty easy this morning, and I say that as somebody who is a free trader, not a fair trader, although I obviously support fair trade as well as free trade. But I generally share the President's philosophical commitment.

Having said that, however, I also don't think you get taken to the cleaners on the issue, as I think this country has been taken to the cleaners during the last year, for a variety of reasons which we might want to discuss.

But the thing that bothers me is that the USTR seems to be about 3 months behind the curve on this issue. And I guess to start with, I would like to know, why is it that that is the case? Is it because of the philosophical position of the administration? Is it because of the organizational problems that we have relating to trade policy, or is it some other factor?

Let me give you just two quick examples that cause me to believe you're behind the curve.

The first is that it's 3 weeks from now that you say you're going to get the suggested legislation up here. The train has been leaving the station for quite awhile on Capitol Hill, and three weeks from now, frankly, you know, isn't very high performance. I think I'd give my staff pretty low marks on that in the way of timeliness.

The second thing is, this morning you come and tell us that H.R. 3131 is something that you have some concerns about, which people have been trying to find out what the position of the administration has been for quite some time now on that piece of legislation, and I'm glad to know that the administration has some concerns. I'm still not sure they are or what suggestions the administration has.

Now that bill has moved out of subcommittee and seems to be on a fairly fast track of moving toward the full committee. If you're going to play in the ball game, you've got to arrive before it's over, I guess is the point.

What's the problem?

Mr. **Feketekuty**. Well, I take your point. What is the problem? Well like the Congress that has many different committees, we in the administration have many different departments.

Mr. **Tauke**. Is it an organizational problem?

Mr. **Feketekuty**. We have to develop a consensus, and that's what we're in the process of doing.

Mr. **Tauke**. Well, you know, does this get us back to this difficulty with—I don't know how many departments, agencies, and bureaus being involved in trade policy—do we need to go back and look at this Department of Trade or some similar concept? Do we need to invest new authority in the Trade Representative's office?

Do you have any suggestions as to how we overcome this?

Mr. **Feketekuty**. I don't think we can get away from many people having to agree, no matter how we organize things. But I can assure you that as legislation moves forward in the Congress, the administration will be ready to talk to you.

Mr. **Tauke**. Yes. I'm sure the administration will be. The problem is that the ballgame may be in the ninth inning by then.

I'd be happy to yield to my leader here.

Mr. **Lent**. I thank the gentleman for yielding to me.

I would like to simply underscore what the gentleman from Iowa has said. And certainly when you go back to your office, you ought to pass along the word that we're Republicans, and we're trying to help you.

But we want you to know that we are well along on this, and probably next week, you're going to see a bill that comes out of here that is some sort of a melding of the LICIT legislation with the TRAC legislation, and you ought to take a copy of those two bills back with you, and whatever the administration comes up with ought to contain as much of that material as is possible.

For example, just a minute ago, the chairman asked you a question about downstream dumping or diversionary dumping, as it is sometimes called. We are going to pick up probably in the legislation that exits before this subcommittee some of those provisions in H.R. 2809, the so-called TRAC bill, that amends the antidumping laws to include downstream dumping and to include certain provisions that would give us remedies in the event that occurs.

And I would hope that any legislation that the administration conjures up would contain similar provisions. But we are on a fast track, and frankly we are rushing to head off what might be something worse.

Mr. **Feketekuty**. I appreciate that, Congressman, and I will certainly take the message back.

Mr. **Tauke**. I thank the gentleman for his comments, and I guess that's my point. I don't want to be overly critical. I'm trying to be helpful. But the problem is that while we may share some of the same views, you guys aren't helping us hold up that position very well. We're getting run over by the protectionist forces in Congress, and we need some other alternatives that I think are more reasonable, responsive, and in the long run will be much more beneficial for the economy of the Nation.

In any event, having given my little sermon on that, let me ask just a couple of other questions.

If we would move to identify industrial targeting as a specific unfair trade practice under section 301, what do you think the administration would—how do you think the administration would react to that? Would they favor that kind of move?

Mr. **Feketekuty**. I don't think at this stage that the administration would favor such a move. On the other hand, I think in the process of talking about the issue, we might find a way of dealing with it.

This is a very difficult issue to translate into legislation, because it deals with intent and motivation, rather than specific measures. If you have legislation that deals with specific measures and tools, that's something you can work with. And indeed, much of our trade legislation really deals with tools.

The problem, when you start talking about targeting as a set of foreign government objectives rather than measures, it is very difficult to draft cogent legislation. But we are prepared to work with you, sir.

Mr. TAUKE. Suppose for a moment—now I recognize that what you say is true; there are a lot of problems with drafting that kind of legislation—suppose you could overcome the problems of drafting the legislation. Is there a philosophical objection to naming targeting as an unfair trade practice?

I mean, it does seem to be something that people are fairly uptight about.

Mr. FEKETEKUTY. I think it's a question of how you identify it, rather than a philosophical objection to naming it.

Mr. TAUKE. OK.

Mr. FLORIO. Would the gentleman yield?

Mr. TAUKE. Yes; I'd be happy to yield.

Mr. FLORIO. I thank the gentleman.

I really do think the gentleman from Iowa has put his finger on the heart of the problem. And certainly it is very difficult to spell out, for example, what constitutes targeting, and at some point, if you reduce things to legislation—and I think this is the administration's argument—you've got to make some arbitrary decisions as to those variables that are in the legislative structure.

But then again, you need discretion on the part of the decisionmaker, whether it be the President, the USTR, whoever, as to whether the targeted thresholds have been crossed or not, whether the legislative definitions have been crossed or not.

And to this point, it is the overall philosophic predisposition not to intervene to make those decisions that has prevailed. Again, I come back to the shoe decision. We have a legislative system—we have a system whereby an industry can come forward, it has to meet all of these criteria in order to be categorized as an industry that's been injured as a result of foreign trade. Here is an industry that has leaped over every difficult hurdle and ends up having proved its case, and then there is no interest on the part of the administration in providing remedies.

Industry people say, "How can we expect any assistance from the trade laws when this stands as an example of, even when we run through the eye of the needle, we're not going to get any cooperation because the administration is philosophically locked into a position to not intervene in these trading relationships, because they are inclined to think that the marketplace forces operate in the international arena, when they don't?"

So isn't the gentleman's point that it is a philosophic problem that exists at this point, rather than any technical, mechanical definition problem in defining legislation, that if we work out all of our definitional problems so as to say what constitutes targeting, that we are still going to ultimately have a piece of paper that has to be implemented and interpreted by someone in authority in the administration, and unless the message comes that someone is inclined to take some actions, that we're really almost going through a process that's a gesture?

Mr. FEKETEKUTY. I don't think there are any philosophical problems that the administration has in dealing with unfair trade practices. I really don't think that's the philosophical issue.

In fact, because the administration believes in the advantages of the marketplace, it is quite willing to deal with unfair practices.

Mr. FLORIO. Well, then, if the gentleman will yield just for a minute—how is it that you come to us today and say that you are opposed to the telecommunications bill where we had testimony across the board that there is no equal access of our most productive, competitive industry into the Japanese market?

And yet you say that that's not something today that you can support, even though 2 days ago there wasn't that degree of finality from the administration in terms of its position on this bill.

Mr. FEKETEKUTY. It comes down to a question of how do you want to run your government, and the President does not believe that he should support legislation that leaves him no discretion. It comes down to issues of government, how the government is run.

Mr. FLORIO. Philosophic issues of how government is run.

Mr. FEKETEKUTY. Right.

Mr. FLORIO. I yield back to the gentleman.

Mr. TAUKE. I thank the gentleman for his comments. Let me pursue it a little differently.

Do you think targeting is an unfair trade practice?

Mr. FEKETEKUTY. I think individual measures that add up to targeting are unfair trade practices. Targeting is nothing but a sum of actions.

Mr. TAUKE. OK. Well, then, do you think there is ever any justifiable reason for permitting targeting?

Mr. FEKETEKUTY. Again, I think it gets down to motivation and intent. I'm not sure you can get behind the other government's motivation or intent.

But certainly actions that they take that go against the operation of the market, those should be dealt with.

Mr. TAUKE. Well, you know, we're in the business of making a lot of these strange judgments, trying to figure out what's reasonable and what's fair, what's clean when it comes to pollution controls and so on. And somewhere along the line, I suspect we'll have to make some judgments along these lines, too.

And going back to my plea, it seems to me it would be helpful if you would deal yourself into the game and be part of the process which is making some of those judgments, and second, not leave us in a position where we fear that if we leave—give the administration discretion on all these issues, which I favor, leaving as much discretion as possible, that none of the discretionary authority will ever be used. Because as soon as people believe that no discretionary authority will ever be used, then they start mandating lots of things.

That's the position that we are in now. And so I say to you, I generally, you know, am philosophically attuned with your views on trade—I think I am—but I think you've got to show that you really are willing to back up your words about unfair trade practices with some action, or otherwise you aren't going to have much discretion in the years ahead.

Mr. FEKETEKUTY. Well, we would have hoped that the President's action in initiating 301 cases would signal a determination there, that you would accept that as an article of good faith on the part of the administration and the part of the President.

Mr. **Tauke**. There has been improvement.

I thank the gentleman.

Mr. **Florio**. The gentleman emphasized or at least focused for a bit on the concept of targeting and asked if there were any ways that one could justify it. Coming from the perspective that you're coming from or the administration is coming from if one takes the broad philosophic approach that the marketplace forces will pick the winners or the losers, isn't there an argument that can be made that a major industrial nation is not going to be a major industrial nation if it doesn't have a basic steel industry. If the marketplace forces play out such that you're not going to have a steel industry, is there not then more than sufficient justification for a targeting on the part of a governmental system, public accountability, in attempting to preserve that steel industry, to make it competitive and to take those actions necessary to stop the marketplace forces from resulting in the total dismantling of a key industry?

That concept of targeting is not something that some of us are offended by, because it is almost a part of national security, the national need to be economically viable.

Do you have any difficulties with that approach?

Mr. **Feketekuty**. No, sir.

Mr. **Florio**. Let me recognize the gentleman from New Mexico.

Mr. **Richardson**. Thank you, Mr. Chairman.

I will not have any questions for the witness. I do regrettably have another pressing commitment.

I just wanted to submit for the record some documentation that I have relating to some Canadian trade practices as it relates to minerals that are very dear to me—uranium, molybdenum, and coal, et cetera.

I have long been concerned about this issue, as the chairman knows. I wish to commend him for the expeditious way that he has been moving in terms of the markup of the telecommunications bill yesterday, and I understand this bill will be marked up, of which I'm a cosponsor, and I would just like to provide for the record this documentation.

[Testimony resumes on p. 497.]

[The information referred to and statement of Mr. Dingell follow:]

Statement for Congressman Richardson on H.R. 1950

Mr. Chairman and members of the Committee, I am pleased to support H.R. 1950. However, I have a couple of suggestions which I believe are very important to address weaknesses in the current law.

My district in New Mexico encompasses roughly half of U.S. uranium reserves and has long been the pre-eminent source of uranium for the U.S. However, as I speak, the industry in my district has ground to a halt. Roughly 8000 jobs have been lost. Local communities have been devastated. One of the most important reasons for this situation is unfair trade.

The bulk of U.S. uranium imports are from Canada. I will focus on that country's practices below, and then turn to what should be done in response. I will submit to the Subcommittee documentation, chiefly from Canadian sources, for all my factual assertions.

One fact that is clear is that the government of Canada does not follow a "laissez-faire" or non-interference policy with respect to its uranium supply industry. To the contrary, Canada is heavily involved in its uranium industry -- some of the principal producers are owned either by the Canadian government -- such as Eldorado -- or by the Province of Saskatchewan -- such as Saskatchewan Mining Development

Corporation (SMDC).[1] Moreover, the Canadian government allocates Canadian requirements among Canadian producers, excludes U.S. producers from its market, and in general restricts U.S. ownership of Canadian uranium resources to 33% or less.[2] Canada reviews the prices and terms of all uranium export contracts.[3] The Canadian Supreme Court has held that Canadian uranium producers such as Eldorado are immune from Canadian antitrust laws when they enter into agreements with other companies to restrict production or to raise prices on export sales.[4]

Canada has also heavily underwritten its uranium industry. By this I do not mean the typical kinds of things governments do to support economic development, such as the construction of roads and schools and so forth. Instead, I refer to direct infusions of cash or cash equivalents. In the last few years, Canada and its provinces have poured in excess of $1,000,000,000 into Canadian uranium producers.

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[1] Compare Eldorado's Annual Report 1983 with SMDC's Annual Report 1982 (Attachments 1 and 2).

[2] U.S. Department of Energy, The Domestic Uranium Industry and Imports of Uranium at 36 (Feb. 23, 1981) (Attachment 3).

[3] See, e.g., Campbell, Exhaustible Resources and Economic Growth: The Case of Uranium Mining in Saskatchewan (a paper prepared for the Economic Council of Canada) (Sept. 1984) at 55 (Attachment 4).

[4] See The Queen v. Eldorado Nuclear Ltd., decided Dec. 15, 1983, Supreme Court of Canada Reports Service, Digest 1045 (Attachment 5).

For example, Eldorado (which, as I said, is owned by Canada) was given $300,000,000 worth of uranium from the Canadian government stockpile, in return for which Canada received yet more stock in Eldorado, i.e., more paper. Moreover, according to Eldorado's annual reports, Canada "forgave" a $100,000,000 loan to an Eldorado subsidiary.5/ SMDC's annual report indicates that the Province of Saskatchewan has provided $250,000,000 in so-called equity advances to the company and has provided or guaranteed certain SMDC long-term debts.6/ The Province of Ontario, through a company owned by the Province, has advanced more than $600,000,000 interest free to two other Canadian producers.7/ All this has contributed to increasing Canadian capacity and to lowering Canadian costs and business risks.

Canada provides additional support to its producers. For example, there is a very significant price differential between Canada's high home market prices and Canadian prices down here. Unlike the U.S., Canada requires its nuclear utilities, the principal one of which is Ontario Hydro, to secure their uranium supplies years in advance.8/ The prices paid by Ontario

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5/ Eldorado's Annual Report 1981 at 2 and 25 (Attachment 7).

6/ SMDC's Annual Report 1983 (Attachment 2).

7/ See, e.g., Wall Street Journal, Oct. 8, 1981 ($600,000,000 interest free loan to Denison and Rio Algom); Nuclear Fuel, January 4, 1982 (same); Nuclear Fuel, March 28, 1983 (same) (Attachment 8).

8/ See, e.g., Campbell, supra at 53 (production allocated so secure supply for 30 years); U.S. DOE, supra (15 year forward supply must be contracted).

Hydro in Canada are in the neighborhood of four times the price at which Canadian uranium is being sold on the U.S. market -- roughly $60 as compared to $15 per pound.[9/] Canada's policy thus in effect allocates its higher cost uranium to its own utilities at high prices and makes its lower cost uranium available in the U.S. at very low prices.[10/] Moreover, in the words of Marc Lalonde, speaking as Canada's Energy and Mines Minister, Canada is "strongly encouraging [Canadian] producers to export their surplus [to] the United States."[11/]

The net effect of this situation is that import commitments for uranium from Canada (and, incidentally, other countries) into the United States are growing rapidly.[12/]

[9/] Nuclear Fuel, June 18, 1984 (Attachment 9) at 4-5 reports that Ontario Hydro will pay (Can) $73.40/pound in 1984, $80.00/pound in 1985, and $91-$98 per pound in 1986-91. $80.00 Canadian for 1985 is equivalent to about $60.00 U.S. These prices do not appear to include repayment of the $600,000,000 cash advance. Ontario Hydro is "recovering" this advance at a rate of approximately $35,000,000 per year. (1985 Ontario Rate Submission at 25 indicates expenditures of $187,000,000 but Fuel Supply Activity Report shows payment of only $150,000,000. The difference is about $35,000,000. See Attachment 10.) Ontario Hydro's 1983 Fuel Activity Report shows purchases of 3,250,000 pounds per year. Given the recovery rate, this works out to an additional approximately $10.00 per pound on the price Ontario Hydro pays for uranium. According to Nuexco, Canadian producers exported uranium to the U.S. at as low as the $15 range in 1984. ($15.46 for Eldorado and $15.68 for SMDC) (Attachment 11).

[10/] See Cong. Research Service Memo, Ellis to Bingaman at 7 (Sept. 27, 1984) (Attachment 12).

[11/] Notes for an Address, The Honorable Marc LaLonde, June 23, 1981 (Attachment 13).

[12/] See Testimony of Bill Stevens on behalf of the American Mining Congress, Review of the Status of the U.S. Domestic

(Continued next page)

Although other factors are also involved, only about 2,000 workers remain in the U.S. uranium industry, as compared to about 20,000 a few years ago.[13] The U.S. used to be self-sufficient in uranium. Market analysts, including the U.S. Department of Energy, now project a U.S. dependency on foreign uranium in the range of 70% or more in a few years.[14]

This renders increasingly significant other aspects of Canadian policy. For example, Canada has an "upgrade-in-Canada" policy. Under this policy, Canada generally requires buyers of Canadian uranium to convert that uranium to uranium hexafloride at Eldorado's conversion facility.[15] As more uranium becomes subject to Canada's upgrade policy, an obvious concern is posed to the continued viability of the U.S. uranium conversion industry.

(Continued)

Uranium Mining and Milling Industry, Hearing before the Energy Research and Dev. Subcomm. of the Senate Comm. on Energy and Natural Resources at 80 (Sept. 12, 1984).

13/ See Testimony of Bill Stevens on behalf of the American Mining Congress, Uranium Enrichment and Uranium Supply, Hearing before the Subcomm. on Energy and the Env. of the Home Interior and Insular Affairs Comm. (March 21, 1985); Testimony of Edward Farley on behalf of Atlas Corporation, same (Attachment 14).

14/ See, e.g., DOE EIA, Domestic Uranium Mining and Milling Industry, 1984 Viability Assessment (1985); Colorado Nuclear Corporation, Review and Critique of Domestic Uranium Mining and Milling Industry: 1983 Viability Assessment at 9 (March 1985) (Attachment 15).

15/ See, e.g., Nuclear Fuel, Feb. 27, 1984, at 4 (Attachment 16). See also Reid, The Policy Environment for Saskatchewan Uranium Producers, at 11 (1984) (Attachment 17).

The next question is what should be done. I believe that two narrow amendments to the U.S. anti-dumping statute would be appropriate. The first would allow long-term prices in the exporting country's home market to be compared to prices in the U.S. where the exporting country requires its purchasers to contract on a long-term basis. Otherwise a country can insulate severe price discrimination and dumping simply by hiding behind some special contracting policy. The second would allow cross-company comparisons of prices for purposes of calculating dumping margins. This amendment is necessary to address government allocation mechanisms reserving domestic require-ments to certain producers and allocating foreign markets to other producers. This amendment is eminently fair, and will assist in filling a gap in current U.S. anti-dumping law.

1984 URANIUM IMPORTS
December 1984

Quantity (lbs) Imported Under Contracts To Date in 1984

COMPANY	POUNDS	PRICE/lb.
Eldorado Resources	650,000	$20.05
Eldorado Resources	750,000#	15.46
SMDC	200,000#	18.00
SMDC	1,000,000*	unknown
Uranerz	110,000*	24.00
AGIP	70,000*	24.26
AGIP	42,000	15.84
Rio Algom	1,500,000*	unknown
Uranerz	400,000	24.00
AGIP	700,000#	unknown
Uranerz	300,000#	18.50
AGIP	1,600,000*	16.00
Uranerz	100,000	22.00
SMDC	100,000#	unknown
Eldorado Resources	500,000#	unknown
Uranerz	250,000	24.00
AGIP	238,000	unknown
SMDC	400,000*	15.68
Uranerz	60,000#	20.00
Total	150,000	21.00
Nufcor	1,000,000*	unknown
AGIP	51,000	unknown
Uranerz	500,000	24.00
TOTAL	12,797,000	

Definition

Eldorado Resources (Canadian Government Corporation)

SMDC - Saskatchewan Mining Development Corporation (Province of Saskatchewan Corporation; Canada)

Uranerz - Uranerz Exploration & Mining, Ltd. (Canada)

AGIP -Italian Government Mining Corporation

Nufcor - South African Government Marketing Corporation

* Denotes long-term uranium supply contract.
# Signed during 1984.

Source: NUEXCO, December 6, 1984

Ontario Hydro

1983 ANNUAL REPORT

Fuel Supply Activities

FUELS DIVISION

FUELS DIVISION

1983 Annual Report

Fuel Supply Activities

OOOH SERIES 2.8.2
VOLUME 12.A.6
TITLE: 1983 Annual Report
Fuel Supply Activities

APRIL 1984

1.0 INTRODUCTION

This report details the business activities of the Fuels Division during 1983 with comparative data for 1982. It provides data on primary fuel purchases, contract activity, investments in uranium facilities at Elliot Lake and other activities related to fuel supply. The report is structured to provide a brief review of the above in Sections 2.0 through 6.0. Detailed reports on coal and nuclear supply are provided in Appendices A and B.

2.0 OVERVIEW

Primary fuel purchases in 1983 were $936.9 million (1982 – $1,054.6 million) comprised of coal purchases of $708.9 million (1982 – $896.6 million) and nuclear purchases of $228 million (1982 – $158 million). These expenditures were equivalent to 25% of Ontario Hydro's total revenue in 1983.

Fuel was purchased under 35 separate contracts covering mining, refining, manufacturing, transportation and quality control.

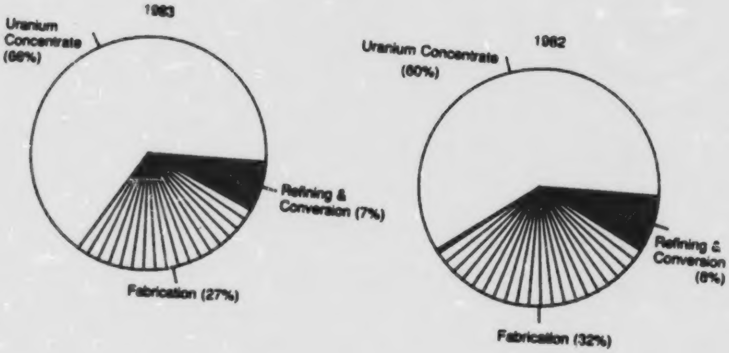
The following quantities were purchased:

	1983	1982
Coal (Tons)	11,322,200	14,825,900
Nuclear (Mg(U))		
Uranium Concentrates	1,250	1,000
Refining and Conversion Services	1,239	1,110
Fabrication Services	1,131	990

[illegible] lbs [illegible]

To convert Mg U (million grams of elemental uranium) to pounds U_3O_8, multiply Mg(U) by 2.6

3.5 Nuclear Purchases by Component



	$ Millions	
	1983	1982
Uranium Concentrate	151.0	95.0
Fabrication	61.5	51.0
Refining & Conversion	15.5	12.0
	228.0	158.0

$95 million ÷ [illegible]
lbs. equals $[illegible]

$151 million ÷ 3.[illegible] million
lbs. equals $[illegible] per pound

- Uranium concentrate supply prices increased more rapidly than the prices of the other components due to the larger percentage of higher priced Elliot Lake uranium

5.0 FUEL SUPPLY CONTRACT ACTIVITIES

1983 was a year of adjustment and consolidation. It was highlighted by the efforts required to meet the extreme variability of expected coal requirements throughout the year. Two nuclear fuel fabrication contracts were awarded in 1983 and one major contract amendment was negotiated. Surplus residual fuel oil and coal transportation equipment was disposed of during the year.

- The volatility in coal requirements had a profound effect on coal suppliers and transportation companies. In early 1983 a 20% reduction in contract coal deliveries was negotiated because of high inventory levels caused primarily by weak power demand and mild weather. By the summer, the economic recovery, nuclear outages, and warmer than average weather required the reinstatement of a significant portion of the earlier downsized quantities.
- An order for 100 Mg(U) of fuel for Bruce A and B was awarded to Combustion Engineering Superheater Ltd. for 1985 delivery.
- A contract for delivery of 25 Mg(U) of Douglas Point fuel was awarded to Westinghouse Canada Inc. but was later cancelled at AECL's request due to changed requirements.
- A reduction in mine development advances required under the Denison Mines Ltd. uranium concentrate contract was negotiated in recognition of the deferment of the Stanrock/Canmet development to 1990.
- Agreement was reached with Thunder Bay Terminals Limited on revenue sharing related to the Terminal's handling of non coal products.
- Sale of the remaining residual fuel oil inventory at Lennox GS was completed to coincide with the station mothballing schedule.
- A railway tank car lease arrangement, with Procor Ltd. was terminated in November.
- Five locomotives and one hundred rail cars, surplus to requirements due to improved cycle times between the mines and the Thunder Bay terminal, were sold to Canadian National Railways.

6.0 INVESTMENT IN FACILITIES

Ontario Hydro has contracted to fund the expansion of Dension Mine's processing capacity from 7100 tons of ore per day to 15,000 tons subject to a limit of $279.9 million in 1983 dollars.

At year-end advances totalled $279.5 million virtually at the limit. During 1983 the mine operated according to plan.

Ontario Hydro has contracted to fund the rehabilitation of Rio Algom's Stanleigh mine to establish a production capacity of approximately 2 million pounds of uranium oxide per year. Original project estimates were $371 million in 1983 dollars.

In 1983 Hydro advanced $87 million bringing its total to $351 million, $20 million under plan. Development of the project was completed during the year and production started in July. Start-up difficulties reduced 1983 production below expected levels.

FUELS DIVISION

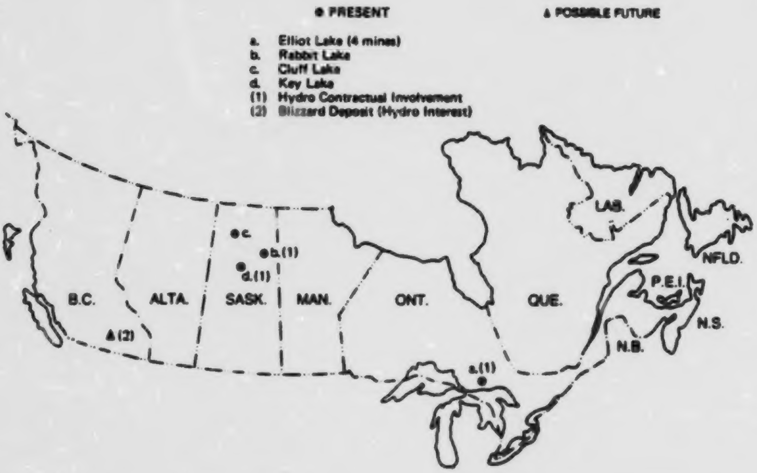
1983
Nuclear
Fuel
Supply

4.0 Uranium Concentrate Procurement and Exploration

4.1 General

Ontario Hydro has arranged for its requirements of uranium concentrates to beyond the end of the century under long-term contracts with Canadian producers. Figure 5 shows the locations of Canadian uranium mines operating in 1983, indicating those which provide long-term supplies to Ontario Hydro. The location of a potential future mine in which Ontario Hydro has an interest is also shown.

Figure 5
Uranium Mines in Canada


● PRESENT
▲ POSSIBLE FUTURE
a. Elliot Lake (4 mines)
b. Rabbit Lake
c. Cluff Lake
d. Key Lake
(1) Hydro Contractual Involvement
(2) Blizzard Deposit (Hydro Interest)
B.C.
ALTA.
SASK.
MAN.
ONT.
QUE.
LAB.
NFLD.
P.E.I.
N.S.
N.B.
c.
b.(1)
d.(1)
a.(1)
▲(2)

4.2 1983 Deliveries

The sourcing of Ontario Hydro's deliveries during 1983 (with 1982 shown for comparison purposes) is displayed in Table 2.

Table 2
Concentrate Deliveries Mg(U)

	1983	1982
Source		
Bancroft	—	20
Elliot Lake	980	710
Saskatchewan	270	270
Total Deliveries	1,250	1,000

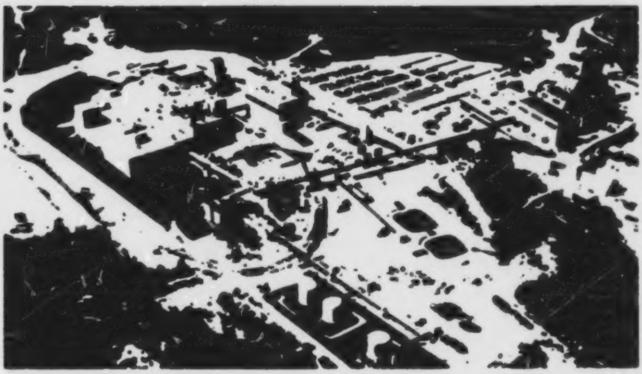
4.3 Elliot Lake Contracts

Two major contracts with Rio Algom Limited and Denison Mines Limited were signed in 1978. These contracts both require Ontario Hydro to advance capital funds for mine construction projects, with the advances to be repaid as credits against the cost of deliveries.

The Denison contract involves an approximate doubling of Denison's 1977 capacity. At the end of 1983 the project was over 90% complete, and the expanded mill was in operation. Deliveries to Ontario Hydro under the contract started as planned in 1980, remained on schedule through 1983, and are scheduled to continue through 2012.

The Rio Algom long-term contract involves the reconstruction and reopening of their Stanleigh Mine (closed since 1960). All production from the orebody (estimated at 28,460 Mg(U) is dedicated to Ontario Hydro, except for 500 Mg(U) which Rio Algom supplied in 1980 and 1981 from its other Elliot Lake mines as advance deliveries and which will be returned out of early Stanleigh production in the 1984-1986 period.

The Stanleigh Mine commenced production on schedule in July, 1983, and production is expected to continue to about 2020.



4.4 Other Long-Term Contracts

Deliveries under a contract with Rio Algom Limited for supply from its Quirke and Panel Mines at Elliot Lake were complete at the end of 1983.

Deliveries under a contract with Eldorado Resources Limited (formerly Gulf Minerals Canada Limited) for supply from its Rabbit Lake Mine in northern Saskatchewan will continue through 1985.

Deliveries under contracts with Eldorado Nuclear Limited and Uranerz Mining and Exploration Limited for supply from the Key Lake Mine in northern Saskatchewan are scheduled to begin in 1985 and to continue through 1993. The Key Lake Mine commenced production in 1983.

4.5 Long-Term Supply Status

Ontario Hydro has sufficient uranium under contract from Canadian producers to provide its forecast requirements for committed nuclear stations until about 2011. Table 3 shows contracts in place as of the end of 1983.

Table 3
Uranium Supply Contracts Mg(U)

	Delivery Period	Total Quantities	Deliveries (Post 1983)	Pounds U_3O_8
Elliot Lake				
Rio Algom (Stanleigh)	1983-2020	28,460	27,810	72,300,076
Denison Mines	1980-2012	44,200	43,700	113,613,837
Saskatchewan				
Eldorado Resources (Rabbit Lake)	1980-1985	1,420	480	1,1[illegible]
Eldorado Nuclear (Key Lake)	1985-1993	2,080	2,080	5,[illegible].727
Uranerz (Key Lake)	1985-1993	3,120	3,120	8,111,540
Total		79,280	77,170	200,[illegible]

4.6 Exploration for Uranium

Due to budgetary constraints and other considerations, Ontario Hydro involvement in uranium exploration field work in 1983 was limited to participation in a joint venture with Amok Ltd. and Saskatchewan Mining Development Corporation (SMDC) on a property adjacent to the Cluff Lake Mine of Amok in Saskatchewan. Funds for this work were provided by SMDC under the terms of an agreement made in 1980 by which SMDC purchased a one-third interest in the venture.

One result of Ontario Hydro's past participation in uranium exploration was the acquisition of a 13.5% share in the Blizzard deposit near Kelowna, British Columbia. If brought to production (not possible at present due to a moratorium on uranium developments in that province) the Blizzard mine could provide about 500 Mg(U) to Ontario Hydro at cost and return a profit on Ontario Hydro's total investments in uranium exploration.

6.6 Contract Status

Table 5 shows deliveries in 1983 as well as those under contract as of the end of 1983. Deliveries in 1982 are also shown for reference purposes.

Table 5
Nuclear Fuel Bundle Manufacturing Quantities Mg(U)

Generating Station	Bruce	Pickering	Douglas Point
1982 Deliveries	540	480	—
1983 Deliveries	630	460	50
1984 - Under Contract	580	280	—
1985 - Under Contract	600	360	—
1986 - Under Contract	500	350	—

7.0 Nuclear Fuel Supply Security

During 1983 individual studies on the supply of concentrates, zirconium alloys and refining/conversion services were revised as part of a continuing review of the security of the nuclear fuel supply cycle. The refining/conversion study formed the basis for an OEB submission on Target Fuel Inventory Levels.

- Security of supply of uranium concentrates is satisfactory, being secured by long-term contracts with Canadian mines for major quantities and backed up by expanding domestic production capability, favourable government policies and excess inventories in Canada and elsewhere.
- The supply of refining/conversion services has received particular attention as the key factor affecting the overall security of the nuclear fuel cycle and fuel inventory target levels. Eldorado Resources Limited is the sole source for these services at present. Alternatives for supply backup have been identified and are currently being evaluated.
- With the current practise regarding bundle inventories, and with the continued availability of at least two viable sources of supply, security of supply of fuel bundle manufacturing services is considered to be satisfactory through 1986. The balanced orderly development of the industry beyond 1986 is a matter that will require close monitoring.
- The sourcing of Zircaloy mill products by the bundle manufacturers provides for balanced diversified supply, based on two zirconium producers in the U.S. and one in France, all with surplus capacity. Security of supply of these products is considered to be satisfactory.

LONG-TERM FUEL AGREEMENTS

Ontario Hydro currently has 35 major fuel supply contracts outstanding with a 1983 dollar value of approximately $15.3 billion covering fuel purchases out to the year 2020. Minimum contract quantities have been used to estimate dollar values outstanding.

Supplier	Estimated Outstanding Value ($ Million-1983 Constant Dollars)	Agreement Expiry Date
NUCLEAR FUEL SUPPLY		
Uranium Concentrate	9,377	
Eldorado Nuclear Limited		1993
Denison Mines Ltd.		2012
Rio Algom Ltd.		2020
Uranerz Exploration & Mining Limited		1993
Uranium Refining	167	
Eldorado Nuclear Ltd.		1991
Nuclear Fuel Manufacturing	102	
Canadian General Electric Co. Ltd.		1986
Combustion Engineering Superheater Ltd.		1985
Westinghouse Canada Inc.		1986
Total Nuclear Fuel Supply	9,646	
U.S. COAL SUPPLY		
U.S. Coal	3,497	
United States Steel Corp.		2007
Consolidation Coal Co. Inc.		1986
Consol Pennsylvania Coal Co.		1991
Eastern Associated Coal Corp.		1989
Coal Associates Inc.		1985
Oneida Coal Co. Inc.		1984
ANR Coal Sales Inc.		1985
Rail Transportation and Storage	116	
Consolidated Rail Corp.		1987
Baltimore and Ohio Railroad		1985
Bessemer & Lake Erie		1984
Pittsburgh and Lake Erie Railroad		1984
Procor Ltd.		1990
General American Transportation Corp.		1986
Greenlease Co.		1990
Testing	6	
Commercial Testing & Engineering Company		1988
Vessel Transportation	82	
Upper Lakes Shipping Ltd.		1991
Canada Steamship Lines Inc.		1991
Algoma Central Railway		1991
Total U.S. Coal Supply	3,701	

Ontario Hydro

Submission
on
1985
Electricity Rates

I 1984

Nuclear capability factors and electrical capacity factors — **Table 4-3**

Percent

	1979 to 1983 average	1983	1984	1985
Pickering NGS A capability and electrical capacity factors	84	76	38	41
Pickering NGS B capability and electrical capacity factors	90	90	80	89
Bruce NGS A capability factor	87	90	86	83
Bruce NGS A electrical capacity factor	77	81	77	78
Bruce NGS B capability and electrical capacity factors	-	-	-	79

Net capability factor	– the ratio of the amount of energy (electrical and steam) capable of being produced at a station after allowance for outages and deratings, to the amount it would produce if operated continuously at its maximum continuous rating
Net electrical capacity factor	– the ratio of the amount of electrical energy actually produced (or forecast to be produced) at a station, to the amount it would produce if operated continuously at its maximum continuous rating

FUEL PRICES AND PURCHASES

11. Escalation rates for Ontario Hydro fuel purchases are developed from assumptions, outlined previously in chapter 2, concerning various energy and economic price movements. Forecasts of fuel requirements by year and specific contractual conditions are also applied in forecasting the prices of individual fuels. Water rental price escalation is tied to changes in the Canadian CPI. The forecast annual percentage changes in prices for the major energy sources are presented in table 4-4.

Unit fuel cost escalation — **Table 4-4**

Annual average % change

	1983	1984	1985
Coal	5	(2)	9
Nuclear fuel	16	31	16
Water rentals	5.8	6.0	7.5

12. Coal price increases reflect escalation in production and transportation costs. For coal imported from the United States, price fluctuations occur due to changes in annual contract volumes and requirements, foreign exchange rates and the overall sulphur mix of delivered coal. Weak coal markets in the US will continue to moderate prices in 1984 and 1985. Western Canadian coal prices are expected to increase in accordance with contract escalation provisions.

13. Price increases for nuclear fuel reflect the higher cost of fuel production due to inflation, coupled with the cost impact of supplementing and replacing lower cost contracts for uranium concentrate with new long-term contracts.

14. Coal requirements for 1984 and 1985 will be higher than those forecast last year because of the outages at Pickering Units 1 and 2. Expenditures for delivered nuclear fuel are expected to be sustained at about the same level due to contractual obligations and in order to provide new fuel for restarting these units. Table 4-5 presents projected costs of delivered quantities of fossil and nuclear fuels to meet overall requirements during the period.

Expenditures for fuel purchases — **Table 4-5**

$ millions

	1983	1984	1985
Expenditures			
Fossil	718	873	837
Nuclear	187	193	[illegible]
Total	905	1066	[illegible]

FUEL USED FOR ELECTRIC GENERATION – REVENUE REQUIREMENT

15 The portion of revenue requirement attributable to each of the component costs of fuel used for electric generation is shown in table 4-1 The changes in these component costs from the previous year are shown in table 4-6

Fuel used for electric generation - changes Table 4-6

$ millions change from previous year

	1983	1984	1985
Fossil	61	36	(183)
Nuclear	0	(9)	86
Water rentals	3	2	2
Internal transfers	41	48	12
Total	104	77	(82)

Fuel Costs

16 The revenue requirement for fossil and nuclear fuel is derived from the projected weighted average cost of fuel consumed from station inventories The forecast average unit cost of fuel in inventory takes into account the cost of fuel to be delivered to the generating stations

17 The revenue requirement for fuel used for electric generation is forecast to decrease by $82 million in 1985 This decrease is due to the shift from fossil-fuelled generation to nuclear-fuelled generation partly offset by higher fuel prices and by growth in primary demand

Fossil

18 Coal costs, the main component of fossil fuel costs include charges for US coal, western Canadian coal and lignite taken from generating station inventories Fossil fuel costs for 1985 contain no provision to reduce previously contracted deliveries of oil Fossil fuel costs decrease by $183 million in 1985 due mainly to an expected 27% decrease in fossil-fuelled generation, partly offset by a 9% increase in unit costs The revenue requirement attributable to fossil fuel in 1985 is $730 million

Nuclear

19 Nuclear fuel costs are the costs of fuel used at Pickering and Bruce including a charge for the disposal of irradiated fuel The increased nuclear fuel costs in 1985 are related primarily to new nuclear units placed in service during 1984 and 1985, and higher unit nuclear fuel costs in 1985 The revenue requirement attributable to nuclear fuel in 1985 is $230 million Further items included in the nuclear category are discussed below

20 Past irradiated fuel charges are accumulated to cover the deficiencies respecting the estimated liability for disposing of nuclear fuel used in years prior to the rate year Charges are forecast to remain at about $2 million in 1985.

21 NPD costs are costs for steam purchased from Atomic Energy of Canada Limited (AECL), which owns the Nuclear Power Demonstration reactor The steam is used to power generating facilities owned by Ontario Hydro on the site The price paid for steam is related to unit coal costs The increase in costs to $9 million is due to escalation in the price of coal

22 Cobalt revenue is received from production of cobalt 60 for AECL This revenue, $9 million in 1985, is treated as a credit to nuclear fuel costs

Water Rentals

23 Water rentals are paid to the Province of Ontario and to others for the use of water to generate electricity

24 The water rental agreement with the Province which accounts for most of the rental payments expired in 1982 but was extended for an indefinite period The forecast assumes a continuation of the formula in the agreement which bases changes in water rental rates on the consumer price index Accordingly, payments increase through the forecast period The revenue requirement attributable to water rentals in 1985 is $32 million

Internal Transfers

25 Internal transfers consist of the credit for internal sales the Bruce steam transfer credit and the charge for commissioning energy

(10)

NuclearFuel

A biweekly report from the editors of Nucleonics Week

Vol. 9, No. 13 – June 18, 1984

JUN 20 1984
J. H. S.

PRICES FOR U3O8 TO ONTARIO HYDRO RANGE FROM $34/LB to $98/LB

Based on total figures in Ontario Hydro's 1985 rate submission now before the Ontario Energy Board, calculations show that Ontario Hydro took delivery of some 2.5-million pounds of Elliot Lake uranium concentrates in 1983 at an average cost of (Cdn) $49.14 per pound of U3O8. The utility also bought 702,000 lbs of uranium from Eldorado's Rabbit mine in Saskatchewan province for an average price of (Cdn) $39.90/lb. The Eldorado contract is part of some 17-million lbs of Saskatchewan uranium which Ontario Hydro negotiated two years ago while deferring a like amount of deliveries from Elliot Lake over the next two decades.

rado Resources is supplying 3.7-million lbs from Rab- n the 1980-85 period. Eldorado and Uranerz Explo- Mining Ltd. will together supply 13.5-million lbs next seven years from Key Lake. Key Lake deliver- ... will amount to about 260,000 lbs in 1985, another 1.56-million lbs annually for the next three years and 1.8-million lbs in each of the last three years. Hydro's submission shows that in 1982, Elliot Lake uranium cost the utility about $34/lb, while the Saskatchewan uranium with provincial royalties averaged about $37.20/lb that year. Both Denison and Rio Algom also are now in full production on Hydro contracts at Elliot Lake, and each will be delivering about 2-million lbs of U3O8 annually to Hydro.

Other figures submitted to the Ontario Energy Board in the current rate hearings show Hydro's uranium purchases have or will average about (Cdn) $36.75/lb in 1982; $46.50/lb in 1983; about $73.40/lb in 1984 year, and approximately $80/lb in 1985. In the 1986-91 period, Hydro expects its uranium will cost between (Cdn) $91/lb and $98/lb.

Government opposition was sharply critical of the Elliot Lake contracts signed in 1978, though an all-party legislative committee could find no specific basis for condemning them. Hydro admits that Elliot Lake uranium, which is relatively low grade and must be mined from deep hard-rock deposits, is more expensive than the high-grade Saskatchewan uranium now being produced at the vast Key Lake open pit operation. However, employment and economic benefits tied to the El- " Lake uranium mines and refining facilities at Blind River to help offset the higher Elliot Lake region prices. he uranium is always going to be on the high- d of world uranium. There is no question about ydro's fuel manager Allan Holt told a Canadian legislative committee last year. But, he said 2,500 employees work at Elliot Lake mines. "As production expands and with the multiplier effect we are probably talking about 7,000 to 8,000 jobs involved."

Hydro submitted material comparing Hydro's weighted average price for a pound U3O8 with DOE's weighted average price for known contracts as of January 1, 1983. The material shows that where the Hydro price was about the same as the U.S. average at the beginning of last year, the utility is now paying a third more for Canadian uranium, primarily from Elliot Lake, than the average U.S. contract price. Over the next seven years, Hydro will be paying a third to a half more on their contracted purchases than the average U.S. contract price.

The contract terms for the Elliot Lake uranium are complex, but Hydro could give notice next year that would effectively allow renegotiation to be effective about 1993 on the Denison deal and 1989 with regard to Rio Algom. Hydro's fuel picture is further clouded by the fact that the 1978 contracts were predicated on further nuclear power plants being built after the 3600-Mw Darlington station was completed in 1991. But, Hydro has indicated that there are no plans on the drawing board for post-Darlington plants this century. In the short run, Hydro's uranium surplus also is exacerbated because two Pickering units, totalling 1100-Mw capacity are down for a three to four year period for replacement of pressure tubes.

As part of its (Cdn) $9.4-billion long-term commitment for uranium to 2020, Hydro advanced $290-million for Denison Mine's expansion from 7,100 to 15,000 tons per day of ore and (Cdn) $350-million for Rio Algom's rehabilitation of its Stanleigh mine, all dedicated to Hydro. The interest-free loan is now to be repaid out of uranium sales to the utility. It represents about (Cdn) $70-million a year, or 36% of this year's nuclear fuel bill and 26% next year.—*Ray Silver, Toronto*

ONTARIO HYDRO INVITES CANADIAN PRODUCERS TO BID ON SUPPLY OF 13-MILLION LBS U3O8

Ontario Hydro has invited proposals from Canadian uranium producers for supply of 13-million lbs U3O8, the amount the utility now figures it needs between 1986 and 1993 to cover a shortfall stemming from renegotiated contracts with Rio Algom and Denison Mines (NF, 12 Oct., 1).

Although invitations, due in February, went to producers in Ontario as well as Saskatchewan, the utility is likely to limit its choice to Saskatchewan producers as it attempts to cut its losses from the Rio Algom and Denison contracts.

The Denison contract was renegotiated last October following a year-long Ontario Supreme Court fight. The new pact [illegible] Denison to proceed with the (Cdn) $46-million rehabili-[illegible] of the Stanrock Can-Met mines in return for a [illegible]% reduc-[illegible] 13-million lbs) of the 126-million lbs scheduled for de-[illegible] in the 8-year period.

Hydro also exercised an option with Rio Algom to defer production of 72-million lbs from the Stanleigh mine by 15% annually in the 1983-2004 period.

With Elliot Lake uranium reputedly costing Ontario Hydro 50% or more above current market levels under the long-term contracts, a utility spokesman told NuclearFuel in October: "We will buy at the best price we can get in the Canadian market to moderate the cost from Elliot Lake and that looks like it will be from Saskatchewan producers."

The Elliot Lake expansion, which Hydro is financing up-front against long-term deliveries, was originally expected to cost $340-million in 1975 Canadian dollars. Hydro confirms that escalation will raise the amount to about $610-million by 1983 when capital expansion is completed. Interest on this funding is a significant factor in raising Hydro's cost of uranium under the Elliot Lake contracts.

In the Ontario legislature Dec. 18, Opposition Leader Stuart Smith, noting that Denison production costs were estimated at (Cdn) $22 per pound in 1978, said: "We are told now that the price of production being claimed by Denison is more in the realm of (Cdn) $50 a pound."

Earlier this year Hydro told the Ontario Energy Board that "the price of political security of supply" in the long-term commitment of Elliot Lake uranium would probably cost Hydro "perhaps 1% to 2%" above market prices "but it could be in the range up to $40- or $50-million a year" over the next 10 years.

At that OEB hearing Hydro submitted shot-term fuel cost forecasts. Coal prices were expected to increase 10.7%, 4.8% and 9.6% in 1981, 1982 and 1983 respectively while uranium costs were projected to rise 3.8% in 1981, 17.2% in 1982 and by 24.5% the following year.

the U.S. subsidiary of the French fuel cycle company, under its contracts with customers, reprocessing won't begin until specifications for return of the waste are agreed upon and Cogema is reasonably assured that the country of origin will be ready to receive the wastes on a timely basis, he said at the Atomic Industrial Forum's annual fuel cycle conference, in Kansas City March 20-23.

Bujon also reminded the audience that France's recently published "Castaing Report" on the back end endorsed the current expansion and modernization of reprocessing facilities at La Hague. He was responding in part to fears that the recommendation for separating alpha emitters from reprocessing wastes would mean higher costs (NF, 14 Feb., 9). But he said separation technology is still being developed and would only be applied to an expansion beyond that already planned at La Hague, which wouldn't be until at least 1995.

"In response to the working group's concerns about the uncertainties associated with underground disposal of wastes containing alpha-emitters, CEA (Commissariat a l'Energie Atomique) and Cogema are commencing to develop new reprocessing technology, which is particularly directed toward effecting removal of long-lived alpha-emitters from the waste." But, he said, "technological developments from this program will be incorporated into the design of any future industrial reprocessing plants in France beyond UP2-800 and UP3." UP3 is the planned 800 tonne/year plant scheduled for startup in UP2-800 is the designation for the planned expan- existing UP2 plant.

Bujon said, "Cogema's light water reactor repro- ties constitute a real and growing business. The reprocessing of about 1,250 MTU contained in spent fuel has been contracted for the UP2 plant at La Hague, and about 500 MTU has already been reprocessed," he said.

"Moreover, a total of 30 contracts have been signed with 30 separate utility companies in six countries for the reprocessing of the spent fuel from 70 reactors in the UP3 plant." The countries are Japan, West Germany, Switzerland, Belgium, the Netherlands, and Sweden. The contracts cover a total of about 6,000 MTU of spent fuel from both PWRs and BWRs, he said.

To assist customers in solving spent fuel storage problems, he said, Cogema provided for receipt and storage of spent fuel at La Hague "well ahead of the time the spent fuel is scheduled for reprocessing." All the contracts for UP3 were signed in 1977 and 1978, and the first fuel was delivered in 1981. Deliveries for UP3 are expected to continue into 1990, he said.

Cogema contracts stipulate that all radioactive waste from reprocessing be returned to the customer, Bujon said. Specifications for the return are determined by Cogema, although the customer may request adjustments.

Other basic features of Cogema's reprocessing contracts include Cogema's right to return spent fuel to the customer if mines that the return of reprocessing waste in a timely ll not be possible. But if that decision is made, the returned before 1995, Bujon said.

red plutonium is returned only on the basis of ated need for it in the commercial nuclear programs receiving country. Recovered uranium is returned at the customer's request to an authorized consignee, he said. Customers bear all costs of reprocessing on an equal basis, plus a fee to Cogema. A portion of the costs are required to be paid in advance for funding construction of the reprocessing facilities.

ELLIOT LAKE MINES READY THIS SUMMER BUT STANROCK IS FACING A DELAY

The (Cdn)$600-million expansion of Elliot Lake uranium mines financed by Ontario Hydro's commitment for 187-million pounds of U3O8 over the next four decades will be completed this summer, Denison Mines and Rio Algom report. But Denison does not plan to start working its rehabilitated Stanrock mine until after 1985 and even then it will be phased in at only about a third of its capacity, says Andrew C. Rickaby, Denison vice president. Rio Algom's new Stanleigh mine and mill will be eased into production on schedule in July, but a company spokesman says a revised target is for 4,250 tons per day ore throughput by March 1984. That is 85% of Rio Algom's original quota for Stanleigh.

Current plans for both Denison's Stanrock and Rio Algom's Stanleigh operations reflect Hydro's subsequent adjustments of the long-term contracts that called for some $6.5-billion worth of uranium (all figures are in 1978 Canadian dollars) through the year 2020. In 1981 Hydro negotiated a 9% reduction (11.3-million lbs U3O8) in the Denison contract, which it has replaced with less expensive uranium from Key Lake, Saskatchewan, in the 1985-93 period. At the same time, Hydro opted to defer 15% of Rio Algom deliveries from Stanleigh until the latter years.

The 1978 contracts committed Ontario Hydro to buy 126-million lbs U3O8 worth an estimated $4.1-billion from Denison in the 1980-2011 period and 72-million lbs worth some $2.4-billion in the 1984-2020 period from Rio Algom. Denison has committed all of its Denison Mine reserves to Hydro after major contracts with Japanese utilities terminate in 1993. At the same time it has rehabilitated Stanrock and Can-Met underground workings that have been idle since the late 1960s to meet Hydro deliveries beginning in the latter 1980s. Rio Algom dedicated the entire Stanleigh mine and mill, now almost completed, to meet the Hydro contract. To meet other commitments, Rio Algom upped Quirke mine and mill output from 4,700 to 7,000 tons per day in the 1976-79 period and opened Panel mine and mill to process 3,300 tpd of ore beginning in 1980.

To finance Denison's overall Elliot Lake expansion and Rio Algom's Stanleigh development, Hydro agreed to advance $151-million and $188-million respectively on the basis of 1975 estimates. These advances would be worth some $600-million in current Canadian dollars, NuclearFuel was told. Under contract terms, the up-front money has been credited to Ontario Hydro against future deliveries.

Both Denison and Rio Algom have applied to Canada's Atomic Energy Control Board for uranium mining licenses effective July 1, 1983. "Denison has rehabilitated Stanrock mine, refurbished its shaft and slashed out airways to make them larger," an AECB official told NuclearFuel. "They have done some development to update mining methods and are currently driving to connect this Stanrock development underground with the old Can-Met workings. There is still 600 feet to go to break through. Can-Met shaft has to be enlarged as

The official said that Rio Algom's Stanleigh develop- early completed but "we have asked them to provide ils on ventilation design. They have to conform to ther requirements today."

Better ventilation demands will be applied to Denison as well, he said. "A few years back, we indicated to all licensees at Elliot Lake that we recognized certain difficulties. Denison, for example, is mostly under the lake and could not put vents wherever they wanted. But we told them that any new mines or reopened mines such as Stanrock and Stanleigh would certainly have to provide conditions which result in much lower radon daughters exposure. That is why both mines have had to do extensive underground slashing to provide much higher airflows."

Confirming that just 600 feet of underground connection remains to be completed, Rickaby, who is responsible for Elliot Lake operations, said they expected to have Stanrock and Can-Met workings ready for operation by September this year. However, they will stay idle for at least two or three years.

"We're presently finalizing exactly when it will be necessary to bring Stanrock into production," he told NuclearFuel. "At this time it would appear that we probably won't be bringing Stanrock into production until some time after 1985. We may reach 4,300 tons per day ultimately, but it certainly won't be when we bring it in initially. We don't require the tonnage from Stanrock that we envisaged back in 1979. The great majori of our production now goes to Japan and that will continue 93. Our commitments to Hydro and Japan are such ill be able to phase in the Stanrock operation more than we had originally anticipated. Rickaby said Den- nd AECB officials would be meeting later this month to finalize details on the Stanrock license.

Denison Mine, itself, was modernized to nearly double its underground capacity from 9,800 to 17,500 tpd between 1976 and 1982 and the Denison mill, which will ultimately process Stanrock ore as well, was enlarged from 7,100 to 15,000 tpd capacity in 1980. Denison's original plans were to feed some 12,000 tpd from Denison Mine and 3,000 tpd from Stanrock beginning in 1985. Although the latter target is being pared back, Denison Mine production last year was virtually on target at 11,740 tpd.

Rio Algom plans, as submitted to the Ontario Environmental Assessment Board back in 1978, called for expansion of Quirke mill throughput to 7,000 tpd and Panel mill to process 3,300 tpd. By 1981, the latest figures available, both of these Rio Algom mine/mill operations at Elliot Lake were close to target. Quirke Mine milled 6,726 tpd on average in 1981; Panel milled 3,123 tpd. – *Ray Silver, Toronto*

JAPAN'S PNC COMPLETES CONVERSION PLANT, CALLED FIRST OF ITS KIND IN THE WORLD

Acting on the 1977 U.S.-Japanese reprocessing agree- hat called for uranium and plutonium co-processing, actor & Nuclear Fuel Development Corp. (PNC) has d a $30.3-million facility to convert the mixture into xide fuel. The latest PNC fuel plant at Tokai village is ned to produce 10 kilograms of MOX daily, large enough to consume all the raw materials sent from the adjacent (and currently idle) 210-metric-tons-a-year spent fuel reprocessing plant.

PNC said that it has become the first anywhere in the world to have completed a plutonium and uranium co-conversion plant. It is scheduled to start up the facilities in the last half of this year after testing with uranyl nitrate.

Unveiled to the Japanese press and McGraw-Hill on March 11, the PNC technology is called direct denitrification. Plutonium nitrate and uranyl nitrate, as supplied from the reprocessing plant, will be first mixed at the conversion plant. The mixed solution is designed to be heated by microwave "like a home electronic cooking range," says a PNC manager. The hour-long heating on an oversize "frying pan" yields a mixture of plutonium dioxide and uranium trioxide, which is then roasted to about 700 C (low enough to prevent melting) to convert the mixed oxide into plutonium dioxide and U_3O_8. Still staying in the roasting-reduction section, the mixture is reduced in an atmosphere of nitrogen hydrogen gases into plutonium dioxide and uranium dioxide mixture. The ensuing operation crushes and screens, with relatively large powder particles recycled to the crusher.

The whole process inside the six airtight, tall boxes takes eight hours to complete. The mixed oxide powder will initially be consumed for fabrication of fuel for PNC's prototype advanced thermal reactor, Fugen, at Tsuruga. In the long term, the plant will serve as a MOX source for the experimental fast reactor, Joyo at Tokai as well as the planned prototype breeder, Monju, says Munihiko Uematsu, PNC's fuel general manager.

To run the plant and plan conversion enterprises, PNC formed a conversion technology development division, with about 80 members, last October. One half of the division staff is slated to operate the MOX production plant. The other half is responsible for technology development (one goal is realizing a continuous process), maintenance and other services as well as planning.

Conversion of plutonium nitrate (and uranyl nitrate) is a major but not the only task for the new division. Uematsu emphasizes that it is designed for other jobs, too, including denitrification of just uranyl nitrate and conversion of depleted uranium from PNC's enrichment plant.

PNC started its development efforts in November 1977, two months after the U.S. government allowed it to reprocess spent fuel on condition that it develop a co-processing technique. By September 1979, PNC completed a smaller (two kilograms daily) facility that has so far produced one metric ton of MOX powder for the Fugen ATR.

It is understood in Tokyo that the U.S. Department of Energy has suspended is coprecal (co-processing and calcination) technology. The PNC direct denitrification process is said to be simple, a factor contributing to the compactness of a plant with total floor space of 5,000 square meters (1.2 acres). Waste liquid generation is reduced to about one fifth of what a conventional process (e.g., precipitation with oxalic acid for conversion of plutonium nitrate solution into plutonium dioxide) generates.

RIO ALGOM LTD. REPORTS GROSS REVENUE ON URANIUM DOWN ONLY MARGINALLY

Rio Algom Ltd. reported uranium gross revenue only marginally down despite 9.4% less production in 1982. The company's operating profits on Ontario and Utah mines, how-pressed the parties to try to reach an agreement without a trial. Marshall over the past year has ruled in TVA's favor on a number of motions, but observers noted that his statement in a court transcript in October (Nucleonics Week, 13 Oct. '83), that he was considering ruling that Gulf was liable for damages and letting a jury decide only the amount of damages was an incentive for Gulf to settle.

Marshall had previously ruled that TVA was entitled to treble damages under the antitrust laws. He also had ruled that Gulf "willfully and intentionally placed substantial evidentiary materials in Canada for the purpose of making them unavailable in litigation." He said sanctions were in order for that action by Gulf.

TVA officials would not comment on the nature of the venture firm that Gulf would fund, but sources noted that TVA has been a leader in efforts to create a high technology corridor between Knoxville and the nuclear complex at Oak Ridge, where several nuclear service industry firms are already located. One observer noted that Gulf could "recoup the amount of the entire settlement if the venture thing works out. That is one of those deals where everybody can win."

TVA has previously said that it has recovered a total of about $100-million in cash and services from the various settlements with other producers and Westinghouse. One observer noted that the settlement proposal came just as the Canadian government was dropping its cartel litigation effort. "That did not strengthen TVA's case," he allowed.

– James Branscome, Washington

CANADIAN ANTITRUST PROSECUTION IS DROPPED

The Canadian government has dropped its antitrust charges against six Canadian uranium suppliers but the resentment lingers on. "In view of the Supreme Court decision that the two crown corporations could not be prosecuted it would be unfair to continue against the private companies," a spokesman for Justice Minister Mark MacGuigan told NuclearFuel. "So the minister used his prosecutionary discretion and said there would definitely not be any further action against Canadian uranium producers."

MacGuigan's instructions to special counsel John W. Brown of Toronto to drop the uranium cartel charges came less than a week after the Supreme Court of Canada in a 5-2 decision declared that the government could not prosecute two of its own agencies, Eldorado Nuclear Ltd. (now Eldorado Resources) and the defunct administrator of Canada's former nuclear fuel stockpile, Uranium Canada. These two crown agencies along with four private companies were charged in July 1981 in a Toronto criminal court with conspiracy to restrict competition and supply of uranium to Canadian utilities in violation of the Combines Investigation Act. The four private companies were Denison Mines Ltd., Gulf Minerals Canada Ltd., Rio Algom Ltd. and Uranerz Canada Ltd.

Five Supreme Court justices upheld provincial Judge John Holland who had ruled earlier that Eldorado and Uranium Canada had acted strictly as crown agents and that Canada's Combines Investigation Act "did not bind Her Majesty." Justice Bertha Wilson in dissenting said that no law required Eldorado "to respond to government directives" and she did not think it was immune from prosecution.

When counsel for the four private sector uranium producers appeared before provincial court Judge John Kerr Dec. 22, Brown moved to have the charges dropped. "I have no instructions to take any further action and as far as I'm concerned the matter is now completed," he told NuclearFuel.

The private uranium companies were not anxious to comment on the 20-month prosecution by government combines investigators. "Rio Algom considers it acted according to law and the charges against it were unfounded. It would indeed have been inequitable to proceed with this prosecution" following the exemption of the two government-owned companies, said Rio Algom president George R. Albino. Denison Mines executive vice-president Charles D. Parmalee responded with five words: "The facts stand for themselves."

One participant in the meetings at Johannesburg and Paris in 1972 that set up discussions to fix a floor price for uranium sales told NuclearFuel, "There never was any attempt or intention by Canadian uranium producers to influence supply or price within Canada. In fact, they were expressly forbidden to do so." This participant said others shared his resentment at what they considered a "politically inspired prosecution." He said, "The Progressive Conservative opposition goaded the Trudeau government into ordering an anticombines probe of the uranium cartel allegations because members of Parliament recalled in the fall of 1977 were left sitting on their hands when an expected pipeline debate failed to materialize."

The government anticombines charges in July 1981 followed a three-year effort by Joe Clark, then Opposition Leader, and M.P. Sinclair Stevens to obtain some 40,000 pages of correspondence and other documents which passed between Gulf Minerals Canada and its parent Gulf Oil Corp. The documents

NUCLEAR SERVICES: SURVIVING THE SHAKEOUT – WASHINGTON, D.C. APRIL 29 - MAY 2
RESERVE THE DATES – AND PLAN TO SEND YOUR BEST

Sidney M. Stoller of the S.M. Stoller Corp., W.G. Counsil of Northeast Utilities and the editors of McGraw-Hill's nuclear publications are planning a conference to look even harder at the future of the nuclear services market than we did in last year's enormously successful conference. This time, top executives and policy-makers will be addressing such issues as how the shakeout will proceed, who'll survive, how utilities would like the service community to look when it is over, and much more. We're pretty excited about the ideas we've exchanged so far, and we'll soon be providing details. Meanwhile, make a note to reserve the dates.

were stops along the way at Toronto and Mirabel. In my view it was open to the Crown to charge importing at Toronto or at Mirabel or at St-Hubert.

"A number of judgments have referred to the crime of importing narcotics as a 'continuing offence', defined in *Black's Law Dictionary*, 5th Edition, as 'a type of crime which is committed over a span of time as, for example, a conspiracy' and as a 'transaction or series of acts set on foot by a single impulse, and operated by an unintermittent force, no matter how long a time it may occupy'. *Words and Phrases* (Permanent Edition, Vol. 9) defines a continuing offence as, *inter alia*, 'a breach of criminal law, not terminated by single act or fact, but subsisting for definite period and intended to cover or apply to successive similar obligations or occurrences'. Whether the importation of narcotics falls within the ambit of these definitions, or any of them, may be open to debate. In my opinion, however, nothing turns on the definitional niceties. So far as the outcome of this appeal is concerned, it is of no consequence whether the importation of narcotics is or is not regarded as a continuing offence.

"III *The Effect of Police Possession*

"As I have mentioned, the trial judge directed a verdict of acquittal on the ground that continuity of possession had been interrupted by removal by the police of the footstools to St-Jerôme. I agree with the Court of Appeal that the police possesion was irrelevant. The temporary and lawful diversion of the narcotics to the R.C.M.P. detachment at St-Jerôme, for the purpose of testing, could not be said to have terminated the ongoing act of importing. I agree with what was said by Cowan C.J.T.D. in *Whynott* that the goods in question were 'still under the control of customs officials who had delivered possession to the police for a certain restricted purpose'. I find no merit in the appellant's argument on the interruption of possession which found favour at trial."

Appeal dismissed.

Bell v. The Queen, November 24, 1983.

[DIGEST 1045]

Crown — Liability of — Criminal charges under Combines Investigation Act

Two corporations were charged with combines offences in respect of supply of uranium and its products, but prior to preliminary inquiry, accused sought prohibition on the ground of lack of jurisdiction, alleging that each corporation was a Crown agent and not subject to the Combines Investigation Act. Prohibition orders were granted, and upheld by the Ontario Court of Appeal, on the grounds that each corporation was a Crown agent with power to perform the acts giving rise to the charges, capable only of acting as Crown agent, and entitled to the general Crown immunity from the Combines Investigation Act. Dickson J., Laskin C.J., Ritchie, Beetz and Chouinard JJ. concurring: "Parliament has followed the lead of the common law, and taken the development one step further. Section 16 of the *Interpretation Act* removes even the necessary implication exception:

> No enactment is binding on Her Majesty or affects Her Majesty or Her Majesty's rights or prerogatives in any manner, except only as therein mentioned or referred to.

"The conceptual rationale underlying the doctrine of Crown immunity is obscure. In *Bonanza Creek Gold Mining Company, Limited v. R.*, [1916] 1 A.C. 566 the Privy Council said, at p. 586:

> . . . it is the general rule in the construction of statutes that the Crown is not

> affected unless there be words to that effect, inasmuch as the law made by the Crown with the assent of the Lords and Commons is enacted *prima facie* for the subject and not for the Sovereign.

Why that presumption should be made is not clear. It seems to conflict with basic notions of equality before the law. The more active government becomes in activities that had once been considered the preserve of private persons, the less easy it is to understand why the Crown need be, or ought to be, in a position different from the subject. This Court is not, however, entitled to question the basic concept of Crown immunity, for Parliament has unequivocally adopted the premise that the Crown is *prima facie* immune. The Court must give effect to the statutory direction that the Crown is not bound unless it is 'mentioned or referred to' in the enactment.

"The *Combines Investigation Act* contains no section purporting to make the *Act* applicable to Her Majesty. *Prima facie* then, because of s. 16 of the *Interpretation Act*, the *Combines Investigation Act* is not binding on the Crown."

"The Attorney General makes the point that both s. 411 of the 1953-54 *Criminal Code* and s. 32 of the *Combines Investigation Act* used the word "everyone", which was defined in s. 2(15) of the 1953-54 *Criminal Code* (as it still is today) in the following terms:

> 'every one', 'person', 'owner', and similar expressions include Her Majesty and public bodies, bodies corporate, societies, companies and inhabitants of counties, parishes, municipalities or other districts in relation to the acts and things that they are capable of doing and owning respectively.

Relying on the above-quoted provision in the 1960 amending legislation, the Attorney General submits that the word 'everyone' in s. 32 of the *Combines Investigation Act* now has the meaning it had when the section was part of the *Criminal Code*, and s. 32 of the *Combines Investigation Act* therefore applies to the Crown.

"The flaw in the Attorney General's first argument is that the definitions in s. 2 of the *Criminal Code* begin with the words 'In this Act'. In other words, in the absence of a provision expressly incorporating the *Criminal Code* definition of 'everyone' into the *Combines Investigation Act*, the definition applies only in the *Code* itself. In my opinion the provision in the 1960 amending statute to the effect that s. 32 of the *Combines Investigation Act* should not 'operate as new law' is not sufficient to overcome express words in the *Criminal Code* that restrict the definition of 'everyone' to that Act. Section 16 of the *Interpretation Act* requires an express provision to make an act binding on the Crown. The giving of royal assent amounts to a waiver of immunity. In this Court's decision in *Canadian Broadcasting Corporation v. The Attorney General for Ontario*, [1959] S.C.R. 188 (the 1959 *CBC* case) both the majority and dissent agreed that clear language was needed to bind the Crown. The 'shall not be held to operate as new law' stipulation in the 1960 amending Act is far too vague and oblique a reference to have the effect for which the Attorney General contends.

"The Attorney General's second argument is to the effect that the *Criminal Code* definition of 'everyone' is inferentially imported into the *Combines Investigation Act* by s. 27(2) of the *Interpretation Act* which reads:

> All the provisions of the *Criminal Code* relating to indictable offences apply to indictable offences created by an enactment, and all the provisions of the *Criminal Code* relating to summary conviction offences apply to all other offences created by an enactment, except to the extent that the enactment otherwise provides.

"The Attorney General submits that the definition of 'everyone' in s. 2 of the *Code* is a provision 'relating to indictable offences' and as such it applies to offences created by the *Combines Investigation Act*.

"With respect, I disagree. The gist of this argument is that s. 27(2) of the *Interpreta-*

tion Act incorporates the *Criminal Code* definition of 'everyone' into all federal penal enactments, thereby making all such enactments binding on the Crown, 'except to the extent that the enactment otherwise provides'. This cannot be right because it is directly contrary to the express words of s. 16 of the *Interpretation Act*, which provides that 'no enactment is binding on Her Majesty ... except only as therein mentioned'. Section 16 makes the Crown immune unless expressly bound, and it cannot be that s. 27 of the same Act binds the Crown unless expressly exempted. In my view s. 27(2) of the *Interpretation Act* does not import the *Criminal Code* definition of 'everyone' into the *Combines Investigation Act*, and it does not make the latter *Act* binding on the Crown.

"Even if the Attorney General could succeed in showing that the *Criminal Code* definition of 'everyone' is incorporated into the *Combines Investigation Act*, he would still face the obstacle posed by the decision in the 1959 *CBC* case, *supra*, where the majority held that the *Criminal Code* definition of the word 'person', which is identical to the definition of 'everyone', did not make the *Lord's Day Act* binding on the Crown, even though that *Act* expressly incorporated the *Criminal Code* definition. The majority view was that the provision that 'person' included Her Majesty was not sufficiently clear to make the Crown criminally liable; it was read as stipulating that Her Majesty could be a victim of crime. The *Interpretation Act*, however, has been amended since this judgment was rendered. In 1959 the exception recognized by the section was: 'unless it is expressly stated therein that Her Majesty is bound thereby'. The new exception clause reads: 'except only as therein mentioned or referred to'. It is not necessary to determine whether the 1959 *CBC* case was rightly decided or whether the result in the case would be the same under the new version of s. 16; for present purposes it is enough to observe that there is some doubt whether the definition of 'everyone' in the *Criminal Code* has the effect of making the *Code*, and any enactment incorporating that definition, binding on the Crown.

"For the above reasons, then, the submission of the Attorney General that the *Combines Investigation Act* binds the Crown must fail."

"Like a corporation, the Crown must act through agents or servants. Assuming for the moment that Uranium Canada and Eldorado were acting as agents of the Crown, where do they stand *vis-à-vis* the *Combines Investigation Act*? The Attorney General submits that even if the Crown is immune, agents of the Crown may be personally liable for breaches of the civil or criminal law. It is argued that the principles applicable to civil and criminal responsibility are the same. The conclusion reached is that a Crown agent may be criminally responsible under the *Combines Investigation Act*."

"At common law, the Sovereign could not be brought into the Queen's courts in the ordinary way. This arose from an immunity of the Sovereign from court process. This immunity was distinct from the immunity of the Sovereign under statutes. Immunity from court process did not, however, leave the subject without any civil remedy. For certain matters, such as breach of contract, the procedure of petition of right was available to settle disputes between the Crown and a subject. In tort the Queen could not be sued but that did not prevent an agent of the Queen from being sued."

"The maxim that the Queen can do no wrong is a legal fiction which, at common law, serves the purpose of preventing the Queen from being impleaded in her own courts. There is, however, no comparable maxim that an agent of the Queen can do no wrong.

"The conclusion that a Crown agent is personally responsible for an unlawful act still leaves the question whether the act is unlawful. Where the unlawfulness or the wrongfulness of the act arises without any recourse to a statute, the Crown's immunity from statute, as expressed in s. 16 of the *Interpretation Act*, is irrelevant. If, for example, the agent commits a tortious act, it is the common law which characterizes it as unlawful. There is no immunity that the agent can claim.

"Where the only source of the unlawfulness is a statute, however, the analysis is entirely different. Reference to a statute is necessary for criminal responsibility in Canada, apart from contempt of court, because s. 8 of the *Criminal Code* precludes any conviction for an offence at common law. If a person commits an act prohibited by statute, and the Attorney General seeks to prosecute for violation of that statute, the preliminary question that must be asked is whether that person is bound by the statute. If not, the person simply does not commit a violation of the statute. The situation is *not* that the person is immune from prosecution even though there has been an unlawful act: *rather*, that there has been no unlawful act under the statute. I have already said that the *Combines Investigation Act* does not bind the Crown. If Uranium Canada and Eldorado share the Crown's immunity, they can have committed no offence under the Act.

"Both the majority and the dissent in the 1959 *CBC* case, *supra*, accepted that proposition of law that s. 16 of the *Interpretation Act* extends to agents of the Crown. This Court's decision in *Formea Chemicals Limited v. Polymer Corporation Limited*, [1968] S.C.R. 754 also makes it clear that a reference to the Crown in a statute extends to Crown agents. If this were not the interpretation given to s. 16, the section would have no meaning, since the Crown only acts through servants and agents. Crown agents benefit from Crown immunity because they are acting on behalf of the Crown. The critical question, then, is whether Uranium Canada and Eldorado were acting as agents."

"The fact that these statutory provisions make each of the respondent corporations 'for all its purposes' an agent of the Crown does not mean, however, that these companies act as Crown agents in everything they do.

"Statutory bodies such as Uranium Canada and Eldorado are created for limited purposes. When a Crown agent acts within the scope of the public purposes it is statutorily empowered to pursue, it is entitled to Crown immunity from the operation of statutes, because it is acting on behalf of the Crown. When the agent steps outside the ambit of Crown purposes, however, it acts personally, and not on behalf of the state, and cannot claim to be immune as an agent of the Crown. This follows from the fact that s. 16 of the *Interpretation Act* works for the benefit of the state, not for the benefit of the agent personally. Only the Crown, through its agents, and for its purposes, is immune from the *Combines Investigation Act*."

"[T]he 1983 *CBC* case makes the same point as the present one: a Crown agent is entitled to the benefit of the immunity afforded by s. 16 of the *Interpretation Act* only when it acts within the scope of the Crown purposes it is authorized to serve.

"I think it is also important to draw a distinction between (i) acts committed in the course of fulfilling Crown purposes: and (ii) those acts committed which are designed to effect Crown purposes. Whereas the latter situation does invoke Crown immunity, the former does not."

"In broad terms, Uranium Canada's corporate functions are to buy and sell uranium and related products with the approval of the Governor in Council, and to exercise such other powers with respect to the acquisition, production and utilization of uranium as the Minister may direct. Uranium Canada is 'for all its purposes' an agent of the Crown. The question that arises is whether entering into a conspiracy or arrangement to reduce competition in the production, sale or supply of uranium is within Uranium Canada's corporate objects and 'purposes'. On this point the Court of Appeal said:

> It can be seen that the respondents are charged with doing acts which by their objects they are authorized to perform. Assuming, as we must, for the purposes of the appeal that the respondent companies performed the acts attributed to them in the indictment then the performance of those acts *prima facie* fell within the powers conferred on them by their objects clauses and their authorizing legislation.

"I have no doubt marketing arrangements relating to uranium come within the powers conferred by paragraph (c) of Uranium Canada's letters patent. They cannot be said to be incidental to the company's powers. Such powers, however, are to be exercised 'subject to the approval of the Governor in Council'. J. Holland J. concluded on the basis of the relevant legislation and the affidavits filed on the application that Uranium Canada is a Crown agent incorporated for the single purpose of carrying out the policy of the government of Canada relating to atomic energy, and that in so doing it operated under the directing mind of the Minister of Energy, Mines and Resources, and with the approval of the Governor in Council. Nothing in the records indicates otherwise. Whether Uranium Canada acted with or without government approval is important because the *Atomic Energy Control Act* provides that Uranium Canada is a Crown agent 'for all its purposes', not that it is a Crown agent in whatever it does. If Uranium Canada performed the acts complained of in the information with the approval of the Governor in Council, it acted within 'its purposes' and is entitled to immunity as a Crown agent. If, on the other hand, it acted without such approval, it acted outside 'its purposes', and beyond the scope of its agency, and cannot claim to be immune on the basis that it entered the alleged combine on behalf of the Crown."

"As with Uranium Canada, agreements relating to the sale and supply of uranium fall within Eldorado's corporate objects. I note, however, that unlike Uranium Canada, Eldorado's corporate objects do not restrict it to acting with the approval of the Minister or the Governor in Council. Whatever the *de facto* relationship between Eldorado and the government may be, the Company's corporate objects clauses and the relevant statutes leaves it free to operate without government direction.

"Does Eldorado's independence in any way affect its right to claim Crown immunity? At common law the question whether a person is an agent or servant of the Crown depends on the degree of control which the Crown, through its ministers, can exercise over the performance of his or its duties. The greater the control, the more likely it is that the person will be recognized as a Crown agent. Where a person, human or coporate, exercises substantial discretion, independent of ministerial control, the common law denies Crown agency statuts. The question is not how much independence the person has in fact, but how much he can assert by reason of the terms of appointment and nature of the office: *Bank Voor Handel En Scheepvaart v. Administrator of Hungarian Property*, [1954] A.C. 584 at 616-17, and see Hogg, *Liability of the Crown*, 1971, p. 207. While Uranium Canada would easily meet the common law test of Crown agency, since it needs approval of the Governor in Council for what it does, I think it is clear that the common law would not recognize Eldorado as a Crown agent since it does not meet the *de iure* control test. I do not, however, think that this deprives Eldorado of the right of Crown immunity when acting within its corporate purposes.

"The position at common law is not that those under *de iure* control are entitled to Crown immunity, but rather that immunity extends to those acting on behalf of the Crown."

"The major difference between Uranium Canada and Eldorado is that while the former is closely controlled by government, the latter, at least on paper, is not. Yet the statutory provisions making both corporations Crown agents for all their purposes are identical. I do not think it is admissible, without rewriting the statutes, to interpret these identical provisions differently. The status of Crown agents 'for all its purposes' gives each such agent the benefit of Crown immunity under s. 16 of the *Interpretation Act*. The draftsmen of the governing statutes of Uranium Canada and Eldorado may well have been thinking of immunity from taxing statutes rather than criminal statutes, but the result is that there is immunity from both as long as the corporations are acting within their respective authorized purposes.

"The Attorney General's 'lawful Crown purposes' argument has already been met by the conclusion that the two respondents are not bound by the *Combines Investigation Act* when acting within authorized purposes, so they cannot commit a violation of that *Act* when so acting. One additional point ought to be made. The Attorney General contended that neither respondent was given authority to contravene the *Combines Investigation Act* and therefore Crown immunity was not available; Crown immunity would apply only if there were statutory authority to contravene the *Combines Investigation Act*. With respect, I do not think this is an appropriate form of analysis. Statutory authority to commit an act that would otherwise be illegal, does not, it seems to me, invoke Crown immunity. It gives rise to a defence of statutory justification. A defence of statutory justification can be raised by any person, whether or not a Crown agent. This is conceptually and analytically distant from Crown immunity.

IV *Where the Prohibition orders premature?*

"There is nothing in the statutory framework or in the letters patent of either Company to suggest that agreements or arrangements to lessen competition in the production, sale or supply of uranium are extraneous to the state purposes for which the two Companies were incorporated.

"The Attorney General says, however, the prohibition orders in this case were premature because the question whether either Company exceeded its authority is a factual matter to be determined only upon evidence the Attorney General will lead in proof of the charges at the preliminary inquiry, and at subsequent trial if either Company should be committed for trial.

"The Attorney General does not make any positive assertion that Uranium Canada acted without approval of the Governor in Council. If the Attorney General had evidence to this effect, or other evidence tending to show that Uranium Canada or Eldorado acted for other than Crown purposes, he should have so indicated by way of affidavit at the application before J. Holland J. No such evidence was presented there, or alluded to here. This matter has now been before three courts. In my opinion there is no merit in the submission that the prohibition orders were premature. The Attorney General has had ample opportunity to demonstrate, or at least assert categorically, that in entering the allegedly unlawful agreements and combinations the two companies acted for other than Crown purposes. The Crown is immune from the *Combines Investigation Act*; the respondents are agents of the Crown. *Prima facie*, the conduct complained of is within the scope of Crown purposes for which the companies were incorporated, which, as found by J. Holland J. is to implement national policy relating to atomic energy in all its aspects. Absent some indication that the Companies acted outside corporate objects for other than Crown purposes, they are immune from the terms of the *Combines Investigation Act* as agents of the Crown, and the Provincial Court Judge lacked jurisdiction to inquire into the charges. I would dismiss the appeals. No costs are sought."

Wilson J., dissenting in part, McIntyre J. concurring: "*Prima facie* the resolution of this issue would appear to involve a consideration of the alleged acts of the corporations in light of their authorized objects and purposes. An inquiry would be required to determine whether or not such acts were within such objects and purposes. It is submitted on behalf of the respondents, however, that such an inquiry is unnecessary since the respondents are expressed in their governing statutes to be for all their purposes agents of Her Majesty and able to exercise their powers only as such. This, they say, means that no matter what they do in carrying out their purposes, they are entitled to Her Majesty's immunity. Parliament has effectively equated their authority with their capacity and the holding of a preliminary inquiry in these circumstances would be a futile exercise.

"Uranium Canada makes its claim to immunity on the basis of s. 10(4) of the *Atomic Energy Control Act*, R.S.C. 1970, c. A-19, which reads:

> A company is for all its purposes an agent of Her Majesty and its powers may be exercised only as an agent of Her Majesty.

"Eldorado's claim is based on s. 3 of the *Government Companies Operation Act*, R.S.C. 1970, c. G-7, which states:

> Every Company is for all its purposes an agent of Her Majesty and its powers may be exercised only as an agent of Her Majesty.

Do these statutory provisions, by making a conclusive legislative pronouncement on the status of the respondents as Crown agents, also provide them with a blanket immunity from prosecution under the *Combines Investigation Act* for any acts which they might perform in furtherance of their statutory mandate? With respect, I do not think so.

"In my view the authorities governing the scope of immunity of Crown agents demonstrate that the courts must apply a two-stept test in determing whether an agent of the Crown is entitled to assert the Crown's immunity. The first step is to decide whether the agent is authorized, expressly or impliedly, to perform the acts in question. In making this determination it is not enough to say that the *purpose* for which the acts are performed is an authorized purpose: the Court must also determine that the *means* which the agent uses to accomplish the purpose are expressly or impliedly authorized. If as a matter of statutory interpretation the means are authorized, the agent is entitled to immunity. If, however, there is no such authorization, the Court must move to the second step. The second step is to decide whether or not the agent is, for all intents and purposes, the alter ego the Crown. If because of the degree of control — and by this is meant *de jure* as opposed to *de facto* control — which the Crown is able to exercise over the agent it is impossible for the Court to characterize the agent's act as anything other than the act of the Crown, the agent is entitled to assert Crown immunity whether or not its governing statute authorizes the means by which the agent carries out its statutory purposes. If, however, the Crown does not have that degree of control, the agent will not be entitled to assert the immunity if the means it used are outside the purview of the statute. I turn to the authorities."

"[T]he fact that an individual or a corporation enjoys the status of an agent of the Crown is not conclusive of his right to immunity. The agent will be personally liable for acts carried out beyond the scope of his authority and his authority must be closely examined in order to determine whether the means he used in carrying out his mandate were authorized or not. Following the approach taken by Evans J.A. in *Stradiotto* I would find that where there is no express authorization to perform the alleged acts, the courts should presume that acts which violate the law are the unauthorized acts of the agent for which he will be personally liable. The onus should be on the agent to show that he could not carry out his mandate without the commission of such acts."

"By applying for an order of prohibition at this stage of the proceedings the respondents in this case have made it impossible for the courts to assess whether or not the acts alleged were necessary to enable the respondents to carry out their statutory mandate.

"It has been argued that by confining the scope of the Crown agent's immunity to those acts which were authorized the Court would be destroying the principle of Crown immunity. The argument is that Crown agents do not need immunity when they are carrying out acts within the scope of their authority. Since the Crown can act only through agents, it is said, the restriction of Crown immunity to the authorized acts of agents deprives the immunity of any substance. With respect, I do not think that this is so. In my view the common law authorities demonstrate that where the Crown agent's capacity to act was so circumscribed that any act done in the course of his duties must be viewed as an act of the Crown itself, he was entitled to assert Crown immunity. The test, as set out in the House of Lords' decision in *Bank Voor Handel En Scheepvaart N.V. v. Administrator of Hungarian Property* [1954] A.C. 584, is whether the Crown exercises *de jure* control over the agent. As Lord Reid put it at p. 617:

> The question is not how much independence the [agent] in fact enjoys but how much he can assert and insist on by reason of the terms of his appointment or the nature of his office.

"I do not see why the common law principle is not equally applicable to individuals or corporations who have been designated by statute as Crown agents. If those agents have the capacity to act for their own purposes as well as for purposes of the Crown, they ill be entitled to immunity only to the extent that they act for purposes of the Crown. e fact that they are designated by statute to be Crown agents for all their purposes does not in my view preclude their acting for purposes of their own if they have the capacity to do so. I believe that the authorities bear out this analysis."

"In my view there is nothing in the governing statutes of either of the respondents to indicate that they were expressly or impliedly authorized to carry out their statutory purposes by engaging in violations of the *Combines Investigation Act*. It may be that the respondents could mount a case that the only way in which they could carry out their mandate effectively was through the acts alleged by the Crown. This question is not, however, before the Court at this stage of the proceedings and any resolution of the issue would have to await the outcome of a factual inquiry. It seems to me, therefore, that neither respondent can be said to be entitled at this stage to assert Crown immunity under the first step of the two-step test for immunity i.e. express or implied authorization.

"Turning to step two — the *de jure* control test — I think that a distinction must be drawn between Uranium Canada and Eldorado. Uranium Canada operates under the direction of the Minister of Energy, Mines and Resources and exercises its powers 'subject to the approval of the Governor in Council'. The identity between Uranium Canada and the Crown is accordingly just about as close as it could be. If the Governor in Council approved the alleged illegal acts of Uranium Canada I agree that Uranium Canada should be entitled to the Crown's immunity.

"Eldorado, on the other hand, has a wide measure of latitude with respect to the way in which it exercises its corporate powers. Indeed, I can find nothing in the governing legislation or in its letters patent to require it to respond to government directives. It is trite law that corporation is a separate entity from its shareholders and that it is to the corporation and not the shareholders that the directors' duties are owed. It seems to me, therefore, that Eldorado's capacity exceeds its authority as agent of the Crown and that it can have 'purposes' of its own. If this is so, I do not believe that its agency status is conclusive of its right to immunity.

"The corporate powers of Eldorado are found in its Letters Patent and Supplementary Letters Patent and in the *Companies Act, 1934*, S.C., c. 33 pursuant to which it was incorporated. Under its principal objects it has the usual powers of a mining company in relation to the exploration for and development of mines and minerals. These powers were expanded by Supplementary Letters Patent in 1968 to add:

> And to purchase, lease, mine, refine, process and sell uranium, zirconium or any other material or equipment relative to the nuclear industry.

It also has extensive ancillary powers under both the *Companies Act, 1934* and the *Government Companies Operation Act*, R.S.C. 1970, c. G-7 including the power to contract in its own name, employ its own officers and servants, and sue and be sued in its own name.

"There is nothing in the Letters Patents, Supplementary Letters Patent or the governing statutes to permit the government or the Minister to interfere with the operation of the corporation. I note, for example, that pursuant to s. 73 of the *Financial Administration Act*, R.S.C. 1970, c. F-10 'the Governor in Council may make regulations with respect to the conditions upon which an agency corporation may undertake contractual commitments'. An 'agency corporation' means a corporation named in Schedule C of the Act and Uranium Canada is a Schedule C corporation. Eldorado, however, is a 'proprietary corporation' or a Schedule D corporation for purposes of the Act and no similar powers of interference in corporate operations is authorized in respect of this type of Crown corporation. Article 8 of the *Financial Adminstration Act* provides the government only with a certain element of fiscal, as opposed to operational, control over proprietary or Schedule D corporations. It is, in my view, quite unrealistic to treat Eldorado either as a matter of fact or a matter of law as the alter ego of the Crown in exercising all its powers.

"In my view the preceding analysis is in accordance not only with authority but with sound policy. It seems to me that when Parliament wishes to give the executive the special powers and immunities it requires to carry out particular government responsibilities, it should do so in clear and unequivocal terms and not rely on either the common law doctrine of Crown immunity or s. 16 of the *Interpretation Act*. I think this is particularly true when it wishes to authorize illegal acts. I see no reason why the Court should contribute to a weakening of Parliamentary control over the executive branch of government by holding that a statutorily conferred agency status is conclusive of the agent's right to immunity.

"I have serious doubts that Parliament ever intended the respondents to have a carte blanche to engage in illegal activities on behalf of the Crown and to encourage other citizens to do likewise. The words of Taschereau J., dissenting in *Canadian Broadcasting Corporation v. Attorney General of Ontario, supra*, at p. 195 come readily to mind:

> I am quite satisfied that it never entered the mind of Parliament that C.B.C. could not be reached by the statute, while all the other private stations, not agents of the Crown, and which are now on an equal footing with the appellant, would be amenable to the law.

We might ask in this case whether Parliament ever contemplated that the respondents would go about the implementation of their statutory purposes by means of an illegal conspiracy with others, counting on the protection of their Crown immunity and leaving their co-conspirators to the full rigours of the law. In the case of Uranium Canada we at least have the comfort of knowing that the corporation is incapable of acting without the approval of the Governor in Council. With respect to Eldorado we have no comfort at all."

Appeal dismissed.

The Queen v. Eldorado Nuclear Ltd. — Eldorado Nucléaire Ltée.; The Queen v. Uranium Canada Ltd. — Uranium Canada Ltée. December 15, 1983.

[DIGEST 1046]

Evidence — Admissibility of — In general — Wiretapping — Authorization — Jurisdiction to review

At trial of betting charges, where Crown's evidence was based on evidence obtained pursuant to authorized wiretap, trial judge held that it had not been shown that other procedures had been tried and failed or were unlikely to succeed, nor was urgency shown, and that authorizations had not been properly obtained, so that evidence was not admissible. The Manitoba Court of Appeal allowed the Crown appeal on the ground that the authorization could not be subjected to collateral attack, and ordered new trial.

McIntyre J., Laskin C.J., and Estey J. concurring: "In the Manitoba Court of Appeal, Monnin J.A. said:

> The record of a superior court is to be treated as absolute verity so long as it stands unreversed.

I agree with that statement. It has long been a fundamental rule that a court order made by a court having jurisdiction to make it stand and is binding and conclusive unless it is set aside on appeal or lawfully quashed. It is also well-settled in the authorities that such an order may not be attacked collaterally — and a collateral attack may be described as an attack made in proceedings other than those whose specific object is the reversal, variation, or nullification of the order or judgment. Where appeals have been exhausted and other means of direct attack upon a judgment or order, such as proceedings by

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Ottawa

A paper
prepared for the

Economic Council
of Canada

P.O. Box 527
Ottawa, Ontario
K1P 5V8

Un document
préparé pour le

Conseil économique
du Canada

C.P. 527
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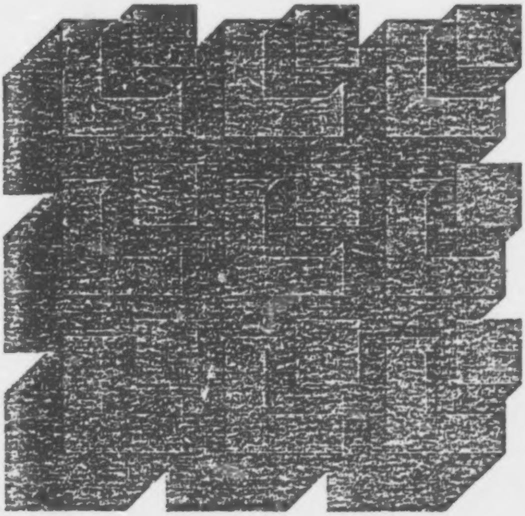
K1P 5V8

DISCUSSION PAPER NO. 270

Exhaustible Resources and Economic Growth: the Case of Uranium Mining in Saskatchewan

by Harry F. Campbell



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DISCUSSION PAPER NO. 270

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ISSN-0225-8013

September 1984

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Acknowledgements

In preparing this study I have received the help and encouragement of officials of the Saskatchewan Mining Development Corporation, Saskatchewan Energy and Mines, Saskatchewan Finance, and Energy, Mines and Resources, Ottawa. I have also benefitted from the suggestions and comments of Brenda Dyack, Michael Percy and Neil Swan of the Economic Council of Canada. None of the above named individuals or institutions is responsible for, or necessarily endorses, the conclusions of the study. I wish to thank Eleanor Tao for typing the various drafts of the paper and for her patience.

ABSTRACT

This study examines the effect of a booming natural resource sector on regional economic growth, with particular attention to the impact of regional government policy on mineral rent taxation and the allocation of resource revenues. The author's approach is first to document the relevant theory and then to apply it to the case of the uranium industry in Saskatchewan.

Chapter 1 draws on a model to illustrate the effect of a resource boom on industrial structure and on factor prices and allocation. Governments often hold the view that a significant portion of resource rents flowing from the boom should be appropriated by the public sector. The usual arguments of efficiency and equity are explained, as is their applicability to uranium in Saskatchewan. The model is extended to include provincial tax and expenditure policies. Chapter 2 concentrates on mineral taxes and examines their various effects on the behaviour of firms with respect to exploration and extraction. Again the theory is reviewed and is subsequently used to anticipate the effect of taxes on uranium mining. The Saskatchewan Uranium Royalty is explicitly considered in a quantitative model to analyse the effect on the rate of extraction on the Key Lake Mine. These chapters support the equity argument for collecting resource rents but have some objections to the efficiency argument. It is agreed that taxes collected by the Saskatchewan government are corrective in nature in that they lower the rate of extraction and make up for certain market failures and improve efficiency of resource use. It is not

accepted, however, that the allocation of these taxes contributes to economic efficiency. Provincial government policy is such that benefits to residents in the form of lower taxes and low prices for publicly supplied goods and services. An incentive is created for persons to move to Saskatchewan and the resulting reallocation of labour creates a welfare loss.

Chapter 3 foresees plentiful low cost uranium reserves but judges that government policy will limit rapid expansion. Weighing these factors and the world uranium market, uranium production forecasts are derived and an estimate is made of the impact of the industry on economic growth in Saskatchewan. The contribution to Gross Domestic Provincial Product in 2000 could be as high as 10% of the 1980 GDPP level and the contribution to employment as high as 9% of 1980 nonagricultural employment. The reader is cautioned that the analysis is extremely speculative and that these percentages are very likely over estimated.

0. Introduction and Summary

The subject of this study is the effect of a booming natural resource sector on resource allocation and regional economic development, taking account of the tax and expenditure policies of the regional government. The analysis is conducted in the context of the impact of the uranium industry on the economy of Saskatchewan given provincial government policy on mineral rent taxation and the disposition of resource revenues. Chapter 1 considers the regional impact of a booming resource sector: it reviews the literature on the effect of a resources boom on factor prices and industrial structure, taking particular account of the effect of government expenditure of resource rent tax receipts. Chapter 2 reviews the effects on mineral extraction rates of various methods of collecting resource rents. The effect of the Saskatchewan Uranium Royalty is analysed by means of a model of the Key Lake Mine. In Chapter 3 some forecasts of Saskatchewan uranium production and price are presented and are used to predict the impact of the uranium industry on Gross Domestic Provincial Product (GDPP) to the year 2020. It is emphasized that these forecasts are at best speculative and are likely subject to an upward bias. The analysis reveals the critical role of provincial government policy in determining the effect of the expansion of the industry on resource allocation and the provincial economy.

The first two chapters of the study are concerned with the equity and efficiency of a system of resource rent taxation and expenditure. It is argued on equity grounds that the public sector should impose some kind of levy on the mineral industry for the use of exhaustible resources which are in the public domain. In the absence of such a levy the share of resource rents accruing to foreigners and the distribution of resource rents within the country resulting from the interplay of market forces is unlikely to accord with the public's view of an equitable distribution. The general tax system with no special levies on resource rents is unable to cope with the requirement of public policy that resource rents accrue to the public sector as resource owner.

Once it is accepted that resource rents will be collected for reasons of equity, two considerations of economic efficiency arise. The first relates to the efficiency effects of collecting resource rents, and the second to the efficiency effects of the public sector's expenditure of resource income. As far as the efficiency effects of resource rent collection schemes is concerned there are two opposing views, one that the taxes are corrective in nature and the other that they impose a welfare loss on the economy. The investigation of the latter contention in Chapter 2 of the study reveals that even if there were no corrective role for mining taxes the deadweight loss resulting from the Saskatchewan Uranium Royalty would be very slight, amounting in the case of the Key Lake Mine to something in the order of 3% of net present value. There are two principle reasons for supposing that the system of uranium royalties serves a corrective function both of which are consequent upon the system's effect in lowering the rate of extraction of the mineral. Firstly, Canada, in conjunction with other non-communist world producers outside of the United States, has some degree of market power and a lowering of the rate of uranium production and sales serves to increase the price received and thereby to improve the efficiency of resource use from a national viewpoint. Secondly, there is reason to believe that various market imperfections and failures in the regional economy may be at least partially offset by a lower rate of uranium extraction. The areas of market failure are the environmental effects of uranium mining and the market imperfections relate to the access of northern residents to the labour market.

The expenditure of resource revenues by the taxing jurisdiction need not in principle result in allocative inefficiency. The distribution of capitalized resource rents on a once-and-for-all poll basis would satisfy the efficiency criterion. While such a use of Alberta's oil revenues has been proposed it is unlikely to achieve political acceptance because it involves an abdication of power on the part of the provincial government and, from the point of view of residents of other areas of the country, it is too blatantly self-serving. The resource rich provinces have chosen a middle ground which involves a combination of saving the proceeds obtained from depleting resource capital and spending them on public and private goods within the province. In order to obtain a share of the public sector benefits resulting from uranium mining in Saskatchewan an individual must reside in that province because provincial government policy results in benefits taking the form of lower taxes and lower prices for publicly supplied goods and services to residents. This policy, therefore, creates an incentive for citizens of other parts of Canada to move to Saskatchewan in order to share in the mineral development. The resulting reallocation of labour creates a welfare loss which can be regarded as a special form of resource rent dissipation.

The impact of the uranium industry on GDPP in the year 2000, for example, is estimated in Chapter 3 to be almost 10% of the 1980 GDPP level. This estimate should probably be regarded as an upper bound as it is based on optimistic production forecasts and on an extreme estimate of the provincial income multiplier. A higher estimate, on the other hand, could have been obtained by assuming that all uranium royalties were used to increase general provincial government expenditure instead of being divided equally among general expenditures, development expenditures, and tax cuts. If the provincial government sterilized resource revenues by investing them outside the province and reinvesting the interest, and if the more pessimistic production forecasts were adopted the impact on GDPP in the year 2000 could be less than 5½% of 1980 GDPP. The industry's impact on employment in the year 2000 could be as high as 9% of total 1980 nonagricultural employment in the province on the basis of the optimistic production forecasts, the assumptions about the disposition of uranium royalties, and the exaggerated provincial income multiplier. On the other hand, if uranium revenues were sterilized and the pessimistic production forecasts were adopted the impact on employment could be as low as 2% of 1980 nonagricultural employment.

While the estimates of the uranium industry's impact on GDPP are expressed in terms of real 1980 dollars, there is some reason to believe that even if the uranium price and production estimates, the assumptions about the disposition of revenues, and the estimate of the multiplier used were accurate the estimates of impact on real GDPP would be too high. It must be expected that the resources boom and its attendant increase in government expenditure will increase wages and costs in Saskatchewan. The higher level of production costs means that the estimates of impact on real GDPP, which are based on the assumption of constant factor prices, are too high. Of course the rise in wages necessary to attract labour from outside the province will be tempered by the government's policy of using uranium revenues to subsidize consumption of publicly produced goods. On the basis of the principle of equal net advantage the wage level and hence the marginal product of labour in Saskatchewan will tend to become lower than in the regions of out-migration. This means that any increases in real output in Saskatchewan may be more than offset by reductions in real output in other parts of the country.

The author's personal conclusion is that resource rents should be taxed for reasons of equity but that they should not be used to finance provincial government expenditure. Rather they should be distributed to the population of the nation as a whole in some relatively nondistorting fashion such as a cut in federal income tax rates. This would allow private individuals to base decisions on where to live on factors reflecting economic efficiency. If resource revenues were distributed as they accrue this policy would also allow private individuals to decide how much should be saved for the future. Alternatively saving for future generations could be accomplished by sterilizing a portion of resource revenues in the manner described above and the resulting income flow could be distributed through income tax reduction.

1 Exhaustible Resources and Economic Growth

1. (i) Introduction

In this subsection some of the literature on the contribution of mineral resources to economic growth is reviewed. In subsection (ii) the effect of a resource discovery or price increase on other sectors of the economy is described in the context of a simple three-sector model with fixed total supply of labour. One of the most significant effects of a resources boom is to encourage in migration of labour and this issue is examined in subsection (iii) using the results of models of fiscal equalization programmes and assuming that the provincial government collects and spends resource revenues. One use to which resource revenues have been put in Saskatchewan and Alberta is the provision of nonresource capital for the benefit of future residents. Subsection (iv) looks at the principle and practice of this allocation of funds. Subsection (v) describes provincial policy objectives in more detail and reviews the predictions of a six sector provincial economy model incorporating immigration about the effects of provincial tax and expenditure policies.

1. (ii) Booming Sector Economics

There has recently been a considerable amount of economic analysis of the effects of a resources boom on the other sectors of the economy. Much of the work concerns the effect of the oil boom on the economies of the OPEC countries, Holland, the UK, Western Canada but there are also studies of the effects of mineral booms in Australia and of resources booms in general. Corden (1982) has written a survey of some forty recent papers on this topic. The present survey describes only those aspects of Corden's study which are particularly relevant to the impact of the uranium boom on the Saskatchewan economy.

The standard model in booming sector economics has three sectors. The booming sector (B) produces tradeables using a specific factor, such as natural resources and industry specific capital, and a nonspecific factor, such as labour, which is mobile among the three sectors so that its wage in all three is the same. The "boom" is caused either by an increase in the exogenously determined world price of good B, as in the case of Saskatchewan's oil, or by a windfall increase in the quantity of the specific factor available to industry B, as in the case of Saskatchewan's uranium. The lagging sector (L) also produces tradeables using a specific factor, such as capital, and the nonspecific mobile factor and, like the booming sector it faces an exogenously determined world price. The nontradeable sector (N) produces goods using a specific factor and the mobile factor. Home and foreign produced goods are assumed to be perfect substitutes and the economy's factor stock is assumed to be fixed.

This simple model, and its many variants, can be used to analyse the effects of a resource boom. There are two types of effects referred to as the spending effect and the resource movement effect. The resources boom is assumed to generate additional income in sector B. In the case of mineral discoveries resulting from exploration the value of the finds are well in excess of exploration costs so that substantial rents are created. Much is made in the literature about whether this additional income accrues to factor owners or to the government but for the moment this issue can be set aside. Whatever the distribution of the additional income some is assumed to be spent on good N causing excess demand, a rise in price, and an increase in output of good N. In a small open economy, the rise in price of good N represents a real appreciation of the exchange rate. Extra output of good N is obtained by a shift of the mobile factor (labour) from sectors B and L. Of course there may also be additional demand for the products of sectors B and L but any change in the excess demand over domestic supply can be met by reduced exports or increased imports at constant world prices. To the extent that additional spending falls short of additional income a trade surplus will develop. In the case of a region like Saskatchewan a trade surplus would tend to be eliminated in the long-run by price and income increases within and factor migration to the province. In summary, the spending effect results in growth of the nontradeable sector at the expense of the tradeable sectors.

When the supply or price of natural resources increases the value of the marginal product of the mobile factor, labour, increases and labour moves out of the L and N sectors and into the B sector. The consequent reduction in output of good N increases the excess demand for that good resulting from the spending effect and causes a further increase in the price of N and a movement of labour from L to N. This further reduction in the output of sector L caused by the reallocation of factors of production within the economy is termed the resource movement effect.

The foregoing is a general description of a model with many special cases. Some of these cases which may be relevant to the experience of a region undergoing a resources boom are briefly described here. It is possible that the economy will experience only one of the effects described above. For example, if the B sector does not employ any of the mobile factor, labour, then there will be no resource movement effect; if all goods are tradeable then there is no spending effect as all changes in demand can be accommodated by trade. Another possibility is that capital will not be specific to the L and N sectors but will move between them. In this case the result of labour moving out of L and N and into B, the resource movement effect, will be to expand whichever of L and N is the more capital intensive. Of course this resource movement effect could be offset by a spending effect. It is possible that capital will not be mobile among the sectors of the economy but will be mobile as between each sector and the rest of the world. In the case of perfect capital mobility there will be no change in the price of L assuming constant returns to scale and mobile labour between sectors. The price of N will also be fixed in these circumstances and all changes in demand will be absorbed by output changes with no change in the real exchange rate.

One of the principal concerns in studies of regional resource booms is their effect on real wage levels. It is often not possible to conclude whether the real wage has risen or fallen in a booming sector model of the kind described above. Any change in the real wage will result from a change in the nominal wage and changes in factor prices and these are usually such that while the real wage in terms of one commodity has risen, it has fallen in terms of the other.

A price index derived from labour's utility function would be necessary to conclude whether the welfare of labour had been increased.

In analysing the question of whether regional wage disparities can be attributed to regional differences in resource endowment, Copithorne (1979) arrives at the extreme view that the wage level will not be affected by a resource discovery in a region provided that the region is not driven to complete specialization. As long as there is a gadget industry operating at constant returns to scale and selling its output at a fixed price in the world market labour can be drawn from this sector into the booming sector without any increase in its wage. If the increase in the resource endowment is large enough to drive the region to specialize completely in the resource based product there will be a tendency for wages to increase but this tendency, Copithorne argues, will be offset by immigration. The problem with this argument, as Norrie and Percy (1982) point out is that there is no equilibrating process: a perfectly elastic supply of migrants confronts the perfectly elastic demand for labour of the gadget industry. In other work Copithorne (1981) avoids this problem by postulating a declining demand curve for labour employed in a continuum of industries with declining regional comparative advantage. This is also the approach adopted in the Norrie and Percy (1982) paper which will be discussed in subsection (v).

1. (iii) Resource Booms and Migration

The main reason for the focus of attention on the effect of resource booms in causing migration is that a sequence of resource discovery, migration, resource exploitation and economic growth has been observed time and time again in the study of economic development (for example, see Marr and Paterson (1980, Chapters 3 and 11) and Maddock and McLean (1983)). While there may be special circumstances in which a resource boom in a region does not affect regional wage levels it appears from the historical evidence that this is the exception rather than the rule.

When labour reallocates itself geographically and across industries in reponse to the wage changes that result from a resources boom it is following a prescription of neoclassical economic theory for efficient allocation of resources. An exception is the case in which the migrant's expectations as to future wage levels and employment prospects are not founded on the best information available at the time of the move. An example might be labour moving to a mining community without having accurate information about, or a realistic assessment of the life expectancy of the mine. Another example is the migration of labour in response to signals other than the wage levels paid by industries in the booming region.

One article of faith held by governments presiding over a resource boom is that a significant portion of resource rents should be appropriated by the public sector. This is sometimes justified on efficiency grounds and sometimes on grounds of equity. The efficiency argument is that a resource subject to open access, such as a fishery or a new mineral territory, will attract other factors of production beyond the point at which marginal social benefits and costs are equalized unless the public sector appropriates the rent thereby removing the incentive for excessive entry. The equity argument is that as owner of a resource the public sector is responsible for ensuring that the use of the resource is such as to benefit society in general and future generations as well as today's. Whatever the rationale for rent collection the fact remains that revenues obtained from a natural resource exploiting industry have to be disposed of in some fashion. In other words, the market distribution of returns is replaced by some other distribution which may result in an inefficient allocation of resources.

There is a literature on fiscally induced migration which examines the effect of federal equalization policies on the allocation of labour. Briefly, the argument is that if the federal government helps poorer provinces to maintain lower tax levels and/or a higher level of expenditure on government provided goods and services than would otherwise be possible the value of the marginal product of labour will not be equalized across regions. The reason for this is that the real wage in the poorer region consists of the nominal wage, or value of the marginal product, plus the value of subsidy on living standards afforded by the federal transfer. Since migration equalizes real wages, net of any costs of adjustment, the value of the marginal product of labour will be lower in poorer than in richer regions in equilibrium and, consequently, the value of national product is reduced by the government's policy. It should be noted that the equalization policy is only one of a number of policies designed to help residents of poorer regions and which have similar effects on the allocation of resources.

The fiscal effects of a resources boom may be similar to those of the equalization programme except that the result will be too much rather than too little migration. When a government such as that of Alberta or Saskatchewan collects large amounts of revenue from its oil or uranium industry it is unlikely that those revenues can be used in a way which leaves unaltered economic incentives consistent with economic efficiency. Two uses of the revenues which would not lead to economic inefficiency are to "privatize" the revenues by allocating them in some arbitrary fashion (for example, to provincial residents as of some date in the past) or to sterilize them by investing them on the money market and not drawing any return from the investment. The former of these proposals, if considered, has already been rejected as politically infeasible by the governments of Alberta and Saskatchewan, while the view that the latter proposal would actually be carried out even if adopted is sufficiently implausible to generate expectations which would result in factor movements inconsistent with economic efficiency. If these two alternatives are rejected then the funds will be used to acquire goods and, in the absence of charity, these will be to the benefit of residents of the province and will encourage in-migration.

The resource revenues are used to acquire both publicly and privately owned investment and consumption goods. For example, the Alberta and Saskatchewan Heritage Funds invest in crown corporations and in private enterprise through subsidized loans; the Alberta Fund has recently been used to subsidize the costs of private housing; and in both Alberta and Saskatchewan resource revenues are used to a significant extent to subsidize publicly supplied consumption services. The result of these uses of resource revenue is an over-allocation of both labour and capital to the jurisdictions concerned. In-migration of labour is predicted to result from the subsidization of government services so that the nominal wage and the value of the marginal product of labour will be lower in these regions than elsewhere. Subsidized loans and cheap labour will attract capital with a higher value of the marginal product elsewhere. The net effect is a dissipation of resource rent akin to that which is predicted to occur in an open-access fishery and for very similar reasons.

In summary, the economic rents resulting from a resources boom appear to present a political and economic conundrum: equity dictates that the rents be collected but that they not be put to the narrow and selfish uses consistent with economic efficiency; efficiency may require that rents be collected to prevent their dissipation by the private sector but political necessity many cause them to be dissipated by the public sector. Before drawing the conclusion that natural resource revenues constitute an embarrassment of riches it is necessary to recall that provincial governments are not solely or perhaps even mainly interested in economic efficiency. The following two subsections examine some of these goals and to what extent they may be furthered by the kinds of expenditures described here. Subsection (iv) deals with the government's obligation to generations living beyond the date at which a nonrenewable resource is exhausted, while subsection (v) deals with a variety of objectives which collectively can be termed "province building".

1. (iv) Exhaustibility and Future Generations

The mineral resources of a particular grade or quality within a province are exhaustible. This means that as the higher quality deposits are used up it becomes increasingly more expensive to find and produce the mineral in question. Eventually production costs may rise to a level at which the industry cannot compete with lower cost industries elsewhere and shuts down. This presumably will be the eventual fate of Saskatchewan's oil, potash and uranium industries. The question arises as to what provision the current users of the resource should make for generations which will be living after the resource has been exhausted.

A mineral stock is a capital good which by itself yields no utility. It does, however, tend to increase in value over time as mineral prices rise and production costs decline. It makes sense to hold capital in this form as long as the return it earns is at least as high as that in an alternative use. If the province's lending and borrowing rates of interest are equal, which is probably a reasonable assumption since it has access to the international capital market, the problems of how much of the mineral to extract and what to do with the proceeds can be analysed separately. The rate of extraction can be chosen so as to maximize the net present value of the resource stock and the returns from the industry can be invested or consumed depending upon the province's preferences. Investments can be made within the province, within Canada or abroad such that the marginal rates of return in all areas and activities are equalized. In this way the resource capital is gradually depleted and consumed or transformed into an alternative form of capital.

With some important exceptions the provisions under which the Alberta and Saskatchewan heritage funds operate are designed to follow the prescriptions of the model of economic welfare maximization. Rates of mineral extraction are determined by market forces except in so far as identifiable market failures in the form of externalities of various kinds dictate corrections, generally in the direction of lower extraction rates. Nonrenewable resource revenues are collected by means of a set of taxes which, in the case of Saskatchewan uranium and, as argued in section 2 of this study, succeed in collecting a substantial portion of mineral rent and in altering the private sector choice of extraction rates in the appropriate direction. The tax revenues are paid into a heritage fund of which a portion is consumed and a portion invested.

At this point reality diverges significantly from the theoretical ideal. It has already been argued that consumption of resource rents in the form of publicly produced goods and services results in rent dissipation through fiscally induced migration. In choosing a programme of investment, for the benefit of future generations, the Saskatchewan Heritage Fund, unlike the Alberta fund, restricts itself to investments within the province. This restriction is likely to lead to some portion of the funds invested earning a lower return than the opportunity cost rate as given by the international capital market. The policy of investing resource revenues internally will, therefore, inflict costs on future generations.

It is arguable that the notion of exhaustibility is not an appropriate one to use in an analysis of public policy towards the extraction of one mineral. Within any reasonable time frame it appears as if Saskatchewan's natural resources are inexhaustible: as oil reserves are depleted uranium reserves increase and the value added by the mineral industry may rise. There is a substantial likelihood that further resource discoveries will replace depleted uranium reserves in the provincial economy. Adopting this view would have little impact on extraction policy since the scarcity rent is likely to be small in relation to the Ricardian and monopoly rents derived from uranium mining. It might, however, have a substantial impact on the manner in which resource revenues are used. If resource exhaustion were not seen as an important issue the proportion of resource revenues invested for the benefit of future residents of the province might well be lower.

1. (v) Government Policy Towards a Resources Boom

One policy which a provincial government could adopt towards a resources boom is to have no policy. In other words, the private market system could be left to allocate factors of production and distribute rents. The outcome of this approach has been described in subsection (ii). There seem to be two sets of reasons why this approach is not followed: in the first place, there are efficiency and equity arguments which put pressure on provincial governments to collect resource rents; and, secondly, these governments have various policy goals which they believe can be furthered by expenditures of mineral revenues.

The efficiency argument for collecting resource rent from the uranium industry can be judged weak for two reasons. First, the uranium reserves are not an open-access resource in the sense that an unregulated fishery or oilfiel is. It is possible that in the absence of resource rent taxation there would be some premature exploration aimed at capturing rights to deposits but the amount of rent dissipation would probably be slight. Secondly, there is evidence of a lack of overriding concern for rent dissipation in the manner in which provincial governments choose to dispose of resource revenues. It is seen as politically infeasible or undesirable to "privatize" the heritage funds, as suggested by McMillan and Norrie (1980), and so programmes of expenditure are undertaken which result in a fiscal dissipation of rent.

The equity argument for the collection of resource rent is, as was argued earlier, persuasive: it is necessary from a political standpoint that the provincial government, acting for the province, be seen to receive a fair or reasonable return from the depletion of nonrenewable resources. Once substantial flows of resource revenue are accruing to the treasury there are two sets of reasons for rent dissipation. First, there is the fundamental inability, cited by Usher (1981), of the legislature to assign shares in resource rent directly to members of society. The politically feasible way of disposing of resource revenues is to undertake expenditures which result in much of the rent being dissipated and in a small amount of it accruing in an indirect fashion to politically influential groups such as urban land holders. Secondly, the expenditures which dissipate rent may help towards achieving various goals which the government has for the provincial economy.

The provincial policy goals identified by Norrie and Percy (1982) are extensive growth and industrial diversification. Extensive growth is seen as a way of increasing the province's influence in the confederation and of taking advantage of agglomeration economies. Industrial diversification is regarded as an insurance against fluctuations in the highly variable primary product markets. Whether or not provincial policies contribute to these goals can be tested by means of the booming sector models described in subsection (ii). The model can be constructed with and without the so called "province building" policies and the contribution of these policies to provincial goals can be assessed. This is approach taken by Norrie and Percy (1982) and the remainder of this subsection reviews their model and results.

The Norrie and Percy model is an expanded version of the booming sector model described earlier. It has six sectors: a nonrenewable resources section (1), which is the booming sector (B); renewable resource, resource processing, and secondary manufacturing sectors (2-4), which corresponding to the lagging sectors (L); and service and government sectors, (5 and 6), producing

nontradeables (N). The advantage of a six sector model is that it will give much more detailed prediction than the three sector booming sector model. Its disadvantage is that it requires a numerical solution and its results may be sensitive to functional forms and parameter values chosen. In the Norrie and Percy formulation labour is mobile among the six sectors and capital is sector specific. They present three sets of solutions: a short-run equilibrium in which there is no in- or out-migration of factors, and no regional balance of payments; a long-run equilibrium in which factor migration in response to changes in factor prices occurs but regional trade accounts are not required to balance; and a long-run in which regional trade accounts are balanced by factor and product price changes and factor movements.

The methods of analysis is first to establish a base case. The effects of a small increase in the price of the nonrenewable resource on the solution values of the model are calculated on the assumption that there are no taxes on resource income. In this model government expenditure is financed entirely by a per capita levy on residents. The predictions of the model are in accord with the standard booming sector model: growth occurs disproportionately in sectors 1 and 5 and 6 which correspond to sectors B and N in the simple model. The results of the base case model are used for purposes of comparison with the solution to a model in which taxes on the returns to resources and capital are used to pay for government produced goods. This means that the per capita levy needed to finance a given output of government goods is lowered below the cost of producing these goods as in the fiscally induced migration model.

The results of the analysis are that, as compared with the base case, the policy of using resource revenues to subsidize the production of government goods and services does result in more extensive growth, defined as the percentage increase in gross domestic provincial product (GDPP). The main reason for this is the fiscally induced immigration of labour. There is, however, a lower rate of intensive growth, defined as the percentage increase in real GDPP per capita evaluated at its opportunity cost. The reasons for the result are the greater immigration of labour because of the subsidy of government output, and the efficiency cost of the subsidy. The effect of the "province building" policy on industrial diversification is harder to guage. Considering the long-run in which the region's trade is in balance, the economy is less diversified than before the resources boom: the proportion of GDPP accounted for by the resource processing and manufacturing industries has fallen. On the other hand, the "province building" policy results in a slightly more diversified economy than occurs in the base case in which no attempt is made to tax incomes derived from the resources boom. In this sense, the provincial policies do make a slight contribution to industrial diversification. Finally, the model confirms the view that the "province building" policy results in rent dissipation since it lowers the real per capita income gain conferred by the resources boom. An exception to this conclusion is the case in which the efficiency gains from agglomeration economies are large enough to outweigh the efficiency costs of factor misallocation through the subsidization of public sector output.

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2. Collecting Mineral Rent

2. (i) Introduction

This section analyses the effects of various methods of collecting mineral rent. There are two important sets of issues to be examined; one relating to the efficiency, and the other to the effectiveness of the various schemes. While in principle the appropriation of economic rent by the government sector should cause no change in private sector behaviour, it is often difficult in practice to design a collection system which applies only to pure rent and at the same time has reasonable costs of administration and collects a reasonable proportion of the rent generated in the private sector. To the extent that the collection scheme appropriates income other than pure rent an incentive will be created for changes in private sector behaviour. In the case of mining firms these are changes in the choice of extraction rate, extraction technique, and cut-off grade which, while they may maximize the net of tax present value of the deposit to the private firm, may lower its gross of tax present value to the economy as a whole as compared with the firm's behaviour in the absence of a tax or similar rent collecting device. This reduction in present value is the efficiency cost of a non-neutral rent collecting scheme. Against efficiency cost, of course, must be set the effectiveness of the scheme which can be thought of as the proportion of economic rent it succeeds in appropriating. The choice of a system of rent collection usually involves a trade-off between the two goals of efficiency and effectiveness.

In subsection (ii) a brief survey of the effects of various mineral taxes on the behaviour of mining firms as predicted by economic theory is presented. While these various taxes are analysed separately it is often the case that revenue is collected from the mining industry by a combination of measures. Subsection (iii) considers the taxes which will be levied on the uranium mining industry in Saskatchewan and predicts the effect of each on the rate of extraction of the mineral. Since some taxes are predicted to increase the rate of extraction and others to lower it the net effect cannot be guaged from a qualitative model. In subsection (iv) a quantitative model is used to analyse the net effect of the various tax measures on the privately optimal rate of extraction for the Key Lake mine which will dominate the Saskatchewan uranium industry in the 1980's. This model, which was presented in a paper by Campbell and Wrean (forthcoming), indicates that the tax regime faced by the uranium industry will cause firms to adopt lower rates of mineral extraction, but that the cost of this distortion will be relatively low while the taxes will collect a relatively large share of economic rent.

2. (ii) The Effects of Mineral Taxation: a brief survey

In this discussion mineral taxation will be interpreted widely so as to include any measure aimed at capturing mineral rent. On this interpretation the outright sale or leasing of mineral resources will be covered as well as the major tax measures which have been proposed and used (for a review see Department of Mines and Energy, Darwin, 1981). These include: a mineral licence, which is an annual charge or lease payment for the use of the resource; a property tax which is an annual charge assessed at some percentage of the value of the mineral property; a severence tax which is a royalty assessed either as a payment per unit of output or as a percentage of the value of each unit of output; a profits tax which if it is to be interpreted as a method of collecting mineral rent must be levied at a higher rate on the mining industry than on industry in general; and a rate of return tax which is a flat rate or graduated tax on profits above an allowable rate of return and which is referred to as a resource rent tax (Garnaut and Ross, 1975). In any given jurisdiction a combination of these measures is normally to be found and the way in which they interact in terms of the deductibili or nondeductibility of one set of tax payments against another tax base varies from jurisdiction to jurisdiction. In the present analysis the effects of each tax measure will be assessed on an individual basis.

All of the rent capturing devices mentioned above are currently in use in some jurisdictions. Conditional rights to oil and gas in the provinces of Alberta and Saskatchewan in Canada and in the U.S. outer continental shelf are allocated to the private sector by direct sale. Many jurisdictions require that mining operations be licensed although the level of license fee usually suggests that the object of the licensing system is one of regulating activities rather than collecti rent. A property tax levied on mines is a common source of local government revenue in the U.S. (Scott, 1973, 194-211). Severance taxes on mineral resources are almost universal: Australian examples are Western Australia's unit royalty of 2.5 cents per tonne of black coal mined, and South Australia's ad valorem royalty of 2.5% of the value of coal produced (Emerson and Lloyd, 1981); it can be argued that severance taxes can take indirect forms such as excess freight charges on mineral products carried by government owned railways. While mining companies are subject to profits tax almost universally, it is unusual to find mineral rent collected by means of a surcharge on the rate of corporation income tax paid by mining companies. The rate of return tax is currently used in a number of jurisdictions including South Africa, Papua New Guinea, Zambia and the provinces of Saskatchewan and Manitoba in Canada (White, 1978).

Before examining the effects of the various taxes on the production plans of mining companies some consideration will be given to the effects of sales of mineral leases as a rent capturing device. In the absence of mineral taxes auctioning mineral leases in a perfectly competitive market will result in the capture of all mineral rent. While much of the literature (Reece, 1979) on this method of collecting rent deals with designing bidding systems which will overcome imperfections in the market for mineral leases, empirical evidence (Mead, 1977) suggests that, at least in the case of U.S. outer continental shelf oil resources, competition has been effective in enabling the government to capture a high proportion of economic rent. When the auctioned mineral property is subject to some form of mineral tax if developed the private sector bids will obviously be correspondingly lower. Mineral rent is then collected as a lump-sum initial payment and a stream of tax revenues conditional on the value of the deposit. [2]

has been argued (Leland, 1978) that this two-part method of collecting resource rent can lead to optimal sharing of risk between the government and the private sector. In view of the advantage of a two-part system in promoting economic efficiency it seems likely that such a system will become increasingly used and it should be borne in mind that the various tax instruments analysed in the following pages will probably be applied to deposits for which firms have already made initial payments.

When analysing the effects of mining taxes it is helpful to treat the effects on extraction and exploration separately. The model commonly used to assess the effects of taxes on extraction plans is that of Hotelling (1931). Hotelling's model is an industry model and it has been criticized (Campbell, 1980) when used to derive predictions about the behaviour of individual firms. Nonetheless the qualitative conclusions of Hotelling's industry model with respect to rates of extraction also hold in an appropriate model of the mining firm and because of its convenience and familiarity it will be used in this survey. In Hotelling's model the mine operator chooses an extraction plan, $q(t)$, and a mine life, T, that maximizes the present value of profit obtained from the mine. The characteristics of the solution to this problem are: marginal profit $(\partial\Pi/\partial q)$, which can be interpreted as the value of an additional unit of mineral reserves, rises over the mine's life at a rate equal to the interest rate; at time T average profit reaches its maximum and reserves are exhausted.

When the impacts of the various mining tax measures described earlier are analysed (Scott, 1973, Burness, 1976, Helliwell and Heaps, forthcoming) using Hotelling's model the following effects on extraction plans can be predicted: a mineral licence which acts as an annual carrying charge on the mine creates an incentive to deplete the mineral stock more quickly and results in higher rates of extraction and a shorter mine life; a property tax which is a carrying charge assessed as a percentage of the value of the mineral stock also creates an incentive to deplete faster thereby shortening the life of the mine; a severance tax or royalty levied at a constant rate on a unit or ad valorem basis shifts the marginal profit function downwards thereby lowering extraction rates and lengthening the mine's life; if the rate of severance tax is known to rise at a rate equal to the rate of interest then the incentive to postpone tax payments is removed and a severance tax of this kind is neutral with respect to the firm's extraction plans; a profits tax in the absence of a depletion allowance is neutral with respect to extraction plans since maximizing the present value of after-tax profits also maximizes before-tax profits; a depletion allowance is in effect a payment to the firm for each unit of the mineral stock extracted and is thus equivalent to a negative severance tax or severance subsidy which creates an incentive to deplete the resource more quickly; finally, a rate-of-return tax is a flat-rate or graduated profit tax which is neutral under the conditions of production assumed in Hotelling's model; it will be argued later that under more realistic assumptions about production the rate of return tax may alter extraction plans.

Hotelling's model is also used by Helliwell and Heaps to analyse the effects of the various tax measures on the level of exploration effort undertaken by firms. The solution to the model involves marginal profit, or the marginal value of reserves, being equated to a shadow-price which rises over time at the rate of interest. Helliwell and Heaps argue that mineral exploration will be carried to point at which marginal finding costs equal the shadow-price. There are two principal criticisms of this approach: in the first place, a deterministic model of mineral exploration is rather unsatisfactory and it has been shown (Devarajan and Fisher, 1982) that with a stochastic mineral reserves production function the equality between marginal finding costs and marginal value of reserves need no longer hold; secondly, models of exploration which equate marginal value of reserves found with marginal finding costs have been criticized (Campbell and Lindne 1983) for disregarding the value of information resulting from exploration effort. Despite these criticisms the following analysis will be based on the proposition that any tax measure which reduces (raises) the shadow-price of mineral reserves reduces (raises) the volume of exploration resulting in smaller (larger) additions to reserves, lower (higher) extraction rates, and shorter (longer) mine lives.

The effects of the various tax measures on the shadow-price of reserves are as follows: a license fee reduces the shadow-price of reserves and discourages exploration; a property tax can be thought of as an ad valorem licence fee which discourages exploration; a severance tax, whether levied at a constant rate or at a rate increasing at the rate of interest, lowers the shadow-price of reserves and discourages exploration. The effect of the profits tax in the Hotelling model is to lower the shadow-price of reserves in the same proportion as the rate of tax. If exploration costs are expensed and fully deducted against taxable income the lower shadow-price or marginal value of reserves is offset by lower marginal costs to the firm of exploration and the profits tax is neutral with respect to exploration effort. In a model which takes account of the value of information yielded by exploration Campbell and Lindner (1983) have shown that this latter result is valid only if firms are risk neutral. If the profits tax is accompanied by a depletion allowance the implicit subsidy on extraction will counter to some extend the lowering of the shadow-price of reserves caused by the tax: a 100% depletion allowance would completely offset the effect of the profits tax on the shadow-price thereby rendering the profits tax neutral with respect to exploration effort but of course such a tax regime would yield no revenue. The rate-of-return tax is a profits tax which will be neutral with respect to exploration effort according to the Hotelling model provided that exploration costs are fully deducted against taxable income. Garnaut and Ross (1979) have emphasized that deductibility of all costs is a cricial feature of their resource rent tax proposal which is a type of rate-of-return tax. As in the case of the profits tax the neutrality of the resource rent tax with respect to exploration effort has been shown (Campbell and Lindner, 1983) to hold only in the case of risk neutrality on the part of mining firms. In summary, any mining tax tends to lower the marginal value of reserves to firms and, in a deterministic model, to lower exploration effort unless this tendency is corrected by some form of subsidy on exploration costs.

The Resource Rent Tax (RRT) is a form of rate-of-return tax proposed by Garnaut andRoss (1975). It taxes at a flat or graduated rate profits in excess of an allowable rate of return on invested capital. It was noted earlier that the RRT is currently in use in a number of jurisdictions. The Hotelling model predicts that the RRT will be neutral and this conclusion is reinforced by a paper by Mayo (1979). The neutrality of the RRT, however, rests on three critical assumptions: full deductibility of costs, an allowable rate of return equal to the firm's cost of capital, and risk neutrality. The importance of the first of these assumptions has already become apparent in the present discussion and is stressed by Garnaut and Ross (1979). The importance of the second assumption is also emphasized by Garn and Ross (1979) and the effect of an RRT scheme in which the allowable rate of return exceeds the firm's cost of capital is analysed by Olewiler (1979). Olewiler' analysis is based on a model of extraction in which capital and labour are used in variable proportions. Setting the allowable rate of return higher than the cost of capital subsidizes the use of capital by the firm and results in an inefficient allocation of capital between mining and other activities. The third of these assumptions is developed by Campbell and Lindner (1983) in a model which analyses the value of information resulting from exploration. The conclusion which results from the various papers cited here is that for a risk averse firm engaging in exploration and using capital and other factors of production to extract ore there is one particular value of the resource rent tax which will not affect exploration effort, and that tax will be neutral with respect to factor proportions and extraction rate provided that the allowable rate-of-return is equal to the firm's cost of capital. Full deductibility of extraction costs is necessary for this conclusion but the rate of RRT can be adjusted to be neutral with respect to exploration depending on whether or not exploration costs are deductible (Campbell and Lindner, 1983). While neutrality is a desirable property of a mineral tax system it is unlikely that the tax rate would be chosen to achieve neutrality independent of considerations of tax revenue.

2. (iii) Neutrality of the Saskatchewan Uranium Royalty (SUR)

The SUR has been described by Anderson and Barnett (1983) and by Kwon (1983). It consists of a basic royalty (SBR) which is an ad valorem tax on the value of production, and a graduated royalty (SGR) which is a graduated rate of return tax. In addition to the SUR uranium mining companies operating in Saskatchewan will be subject to the standard federal and provincial corporation income taxes.

Using the economic theory of the mine described above it is possible to make some predictions about the effect of each component of the tax regime facing Saskatchewan's uranium producers. For example, it is recognized in the mineral economics literature (see Helliwell and Heaps [forthcoming]) that the effect of ths SBR will be to create an incentive for the firm to reduce its planned rate of extraction. Since the royalty can be regarded as an addition to unit cost its imposition may result in some already relatively high cost portions of the ore deposit being abandoned. Whether a lower rate of extraction of a smaller economically recoverable mineral deposit results in a longer or shorter mine life depends upon the individual circumstances. In lowering its planned rate of extraction the firm may alter factor proportions so that the mining operation becomes less or more capital intensive. Again the individual circumstances of production will determine the direction of change. Finally since the imposition of a basic royalty reduces the value of the mineral deposit to the producer the royalty will tend to discourage exploration unless there is some offsetting measure to reduce firms' exploration costs.

The economic theory of the mine has been used to analyse the effects of rate of return taxes in general (Olewiler [1978]), and of the (SGR) in particular (Kwon [1983]). Both these writers concede that a rate of return tax which is neutral with respect to the mining firm's extraction plan can in theory be designed. In practice, however, most schemes which have been used (see White [1978]) have fallen short of this theoretical ideal. In order to identify the shortcomings of the SGR it is helpful to consider first the structure of a tax which is truly neutral with respect to the extraction plan.

The basic principle underlying a neutral rate of return tax is that all costs incurred in undertaking a project can be deducted against taxable income. This principle can be satisfied by not levying the tax until all production costs have been recovered. This can be accomplished by taxing operating profit once preproduction expenses have been recouped. Preproduction expenses can be compounded forward from the time at which they are incurred to a time at which the project starts to yield an operating profit. From this time the unrecovered capital cost of the project continues to be increased annually by an interest factor but it is also decreased annually by the value of operating profit. Once the value of unrecovered capital cost falls to zero there is no capital cost eligible as a deduction against operating profit for tax purposes. Operating profit, defined as gross revenue less production cost where production cost excludes depreciation and depletion allowances, is then subject to tax at a flat or graduated rate.

Before comparing the underlying principle of this tax with the SGR it should be noted that Campbell and Lindner (1983) have argued that even if rate of return tax does not affect planned rates of extraction it may not be truly neutral in that it may affect the amount of exploration which will be conducted on a deposit thereby altering the probability of it being extracted. Thus the "neutral" rate of return tax is likely to be neutral only with respect to those projects which will be undertaken despite the tax regime. Campbel and Lindner show that tax neutrality with respect to all deposits is achieved only if mining firms are risk neutral and if all expenses including exploration costs are deductible from taxable income.

The SGR scheme departs from the basic principle of deductibility of costs in several ways. In the first place, it attempts to isolate each mining project for tax purposes so that only costs associated with a given project can be deducted against income from the project. This means that expenditures on unsuccessful exploration and extraction ventures may not be deductible and this violates a condition for tax neutrality.

Secondly, there is no guarantee that preproduction expenses will be compounded forward at an effective rate of interest equal to the firms's required rate of return on capital invested in the project. All uranium mining firms are required to use an interest rate equal to 110% of the average prime lending rate for compounding costs forward irrespective of their debt/equity ratios and costs of debt and equity capital. Furthermore, as pointed out by Kwon (1983), the procedure originally prescribed by the SGR for compounding preproduction expenses forward may yield a level of capital investment at the start of production which is actually less than the cumulative value of these expenses compounded at the prescribed rate of interest.

Thirdly, in addition to providing for the recovery of capital cost through the deduction of preproduction expenses against taxable profits the SGR allows firms to earn annually an additional 15% of the estimated capital cost at the start of production before they enter a rate of return bracket which is subject to tax. Since the 15% threshold rate is based on the uninflated estimate of capital cost at the start of production the significance of this concession declines in real terms over time. Nevertheless the provision for a successful venture to deduct more than its initial capital cost violates the principle underlying the neutral rate of return tax.

The net effect of these three deviations from the structure of a neutral rate of return tax cannot be predicted on the basis of an abstract economic model. The levying of the tax on a project basis and the possibility that the effective ate of return allowed on capital is lower than the firm's required rate are likely to discourage marginal ventures. On the other hand the failure to tax returns below the threshold rate will tend to encourage larger capital expenditures on projects which do go ahead.

In addition to the SUR the uranium mining firms operating in Saskatchewan will be subject to corporate income tax. An income or profits tax in the absence of a depletion allowance, is neutral in the same limited sense as the rate of return tax since it provides for the deductibility of all project costs. A depletion allowance, however, acts as a negative severance tax and this tends to encourage a faster rate of extraction than in the absence of the tax.

In the following subsection the combined effect of the SUR and a corporate income tax on the extraction plans for a uranium deposit will be assessed by means of a numerical model. The model considers a uranium deposi w has already been explored and which will be extracted under the Saskatchewan x regime. Thus, the model provides no information about the effect of the tax system on the likelihood of a deposit being mined. It simply indicates wheth the net effect of mineral taxation is to raise or lower the planned extractio rate.

2 (iv) Efficiency, Effectiveness and the Extraction Plan for the Key Lake Mine

In this section of the paper a model of the Key Lake Mine is used to determine whether the tax regime within which Saskatchewan uranium mines operate has the property of neutrality. Because of the nature of the model, which is described below, it is not possible to determine if the tax system causes firms to alter factor proportions or to change exploration plans. The model's finding are confined to the effect of the tax system on the optimal extraction rate. Briefly the results are that the tax system results in a fairly wide divergence between privately optimal rates of extraction with and without the tax system but that these divergencies have a relatively low economic cost.

The mining model which is used to examine the effect of the tax system is described in a paper by Campbell and Scott (1980) which analyses a series of Australian uranium mines. The mining cost functions used in the Australian study were of the form $K = Cx^{\alpha}$ where K is cost, C is an intercept term, x is the rate of milling, and α is a scale parameter. In the present study the scale parameters of the Australian study have been retained and the intercept terms have been altered to reflect cost conditions in Saskatchewan. The method of alteration was as follows: estimates of the various mining and milling costs and labour requirement associated with the planned milling rate of 725 t.p.d. for the Key Lake project were obtained from InterGroup Consulting Economists Ltd (1980); the intercept terms for the present study were obtained by setting K equal to the value estimated from the InterGroup data, setting $x = 725$, maintaining the α value used in the Australian study and solving for C. The information used about the Key Lake uranium deposit was that reported in a study of a series of Saskatchewan uranium mines by Campbell and Wrean (forthcoming). The mining model together with the cost functions and the pit data constitute the "Proxy Key Lake Mine (PKL)" which is used to examine the extent and cost of any element of nonneutrality introduced by the tax system.

The PKL in the present paper differs considerably from that of Anderson and Barnett (1983). Their model estimates the net present value of the mine under the federal and provincial tax regime when the milling rate is approximately 725 t.p.d. as planned. This allows them to calculate the revenue shares reported in their paper. The present study obtains a series of milling rates as solutions of the model. For various assumptions about price the milling rates which maximize net present value gross of tax (social value) and net present value net of tax (private value) can be calculated. It can be argued that the latter will be the milling rate chosen by the private firm and that the divergence between it and the former rate is a distortion introduced by the tax system.

In order to maintain comparability as far as possible with the Anderson and Barnett paper the present study incorporates their basic assumptions: the real discount rate is set at 10% and the interest factor used to gross up the Capital Investment Base is set at 6%. Nonetheless it appears that the capital cost and operating cost estimates of the present study are slightly lower than those of Anderson and Barnett: the present study estimates a value at a milling rate of 725 t.p.d. and a uranium price of US$30 per lb U_3O_8 of $1,319 million (1979 Can. $) where as the Anderson and Barnett figure is $1,089 million (1981 Can. $). A further point is that the privately optimal milling rate at a US$30 per lb price is calculated in the present model to be 850 t.p.d. which is somewhat higher than the planned rate of 725 t.p.d. Despite these differences the two models are broadly comparable and the estimates presented below of distortions resulting from the tax system can be regarded as complementing the Anderson and Barnett estimates of the distribution of economic rent.

Following Bradley, Helliwell and Livernois (1981) indices of tax system efficiency and tax share of potential resource value will be used to summarize the performance of the tax system. Tax system efficiency is calculated as follows: for each price of uranium under consideration the mining model is used to calculate the privately optimal milling rate given the tax system and the privately optimal rate with no taxes which, in the absence of external effects and considerations of income distribution, can be regarded as the social optimum; the ratio of net present value of returns to all parties at the privately optimal milling rate to net present value at the socially optimal rate is then a measure of the proportion of potential resource value which is actually realized and as such is a measure of tax system efficiency. The tax share of potential resource value is simply the ratio of present value of tax collections by the federal and provincial governments at the privately optimal milling rate to the project's net present value at the socially optimal rate and as such is a measure of the share of potential resource value captured by the public sector. In interpreting the results it should be noted that the tax revenues include all federal and provincial revenues and not solely the revenues from the SUR, although the latter are a substantial proportion of total revenue, and exclude the returns to the Saskatchewan Mining Development Corporation (SMDC) which is a Crown Corporation owning 50% of the equity in the Key Lake project.

The estimates of optimal extraction rates and net present values obtained from the model for the range of prices considered by Anderson and Barnett and for inflation rates of 0% and 10% are reported in Table 1. Tax system efficiency (E is given for each price as the ratio of column (4) to column (3), while tax share of potential resource value (S) is given by unity less the ratio of column (5) to column (3). The tax efficiency and tax share estimates are reported in Table 2.

It can be seen from Table 1 that the effect of the tax system is to make the privately optimal extraction rate considerably lower than the socially optimal rate. For example, at a price of US$30 the privately optimal rate is only 60% of the socially optimal rate. Since the PKL deposit is fully extracted in both the no-tax and tax scenarios this means that the life of the mine is extended by 60% as a result of the tax system. While the privately optimal extraction rate is considerably lower than the socially optimal rate as a result of the tax system, it can be seen from Table 2 that there is a very low economic cost associated with this distortion: at a price of US$30 per lb, for example, the cost of the distortion introduced by the tax system is $58 million or 3% of net present value. The reason for this relatively low cost is that the function relating net present value to extraction rate is very flat around its maximum point. As Bradley (forthcoming) points out, this is a common feature of mining models described in the economics literature.. Table 2 indicates that the tax system is effective in capturing a considerable proportion of economic rent. The tax share in the no-inflation case ranges from 45-65% and in the 10% inflation case from 56-67%. The reason for the higher tax shares in the latter case is the feature of the SGR referred to earlier that the rate of return for tax purposes is calculated on the basis of the estimate of capital cost at the start of productio with no provision for subsequently adjusting this cost figure for inflation. Th hares reported in Table 2 are not directly comparable with Anderson and Barnett's estimate that 75-80% of economic rent is captured by government. Since the SMDC owns 50% of the equity in the Key Lake Project total government share includes 50% of the private net present value estimates reported in column (5). When this adjustment is made it can be calculated that at a price of US$30 per lb the total government share is 80% in the no-inflation case and 82% when 10% inflation is assumed.

It was implied in subsection (i) that the privately optimal rate of extractio in the absence of taxes could be equated with the socially optimal rate. This assumes that any external and income distribution effects of the mine can be disregarded. In fact the provisions made for health and environmental protection and regional economic development in the Saskatchewan Government Response to he Key Lake Board of Inquiry Report suggest that policy makers are anxious to limit harmful external effects and to ensure that some of the benefits of the Key Lake project accrue to local residents. It has been suggested by Scott and Campbell (1979) that objectives such as these may be served by a policy of attenuation. This policy involves reducing the impact of the mining industry at each point in time and extending its life. One way of achieving this objective is to encourage individual mines to operate at relatively low rates of extraction. It can be seen from Table 1 that this is one effect of the tax regime within which the uranium mines in northern Saskatchewan operate. On the basis of Tables 1 and 2, therefore, it appears that the SUR is a relatively low cost means of collecting a significant proportion of the economic rent from uranium mining and at the same time contributing to the objectives of environmental otection and regional economic development.

Table 1: Extraction Rates and NET Present Values for the PK

	Extraction Rate (t.p.d.) (1) Social Optimum		(2) Private Optimum		Total NPV (millions 1979 Can $) (3) At Rate(1)	(4) At Rate(2)		Private NPV (Milli 1979 Can $) (5) At Rate (2)	
nflation Rate	0%	10%	0%	10%		0%	10%	0%	10%
ice $ per lb.									
15	675	675	475	500	576	551	558	316	255
20	850	850	650	675	957	932	938	443	385
25	1,075	1,075	825	725	1,365	1,346	1,319	567	525
30	1,425	1,425	850	850	1,808	1,747	1,747	722	[illegible]
35	1,700	1,700	1,025	925	2,267	2,200	2.170	858	
40	1,725	1,725	1,100	1,075	2,738	2,645	2,638	1,001	936
50	2,100	2,100	1,425	1,450	3,690	3,622	3,628	1,309	1,242
60	2.k50	2,150	1,550	1,500	4,667	4,374	4,558	1,618	1,551

Table 2: Tax Efficiency and Tax Share for the PKL

	No Inflation		10% Inflation	
Price	Efficiency (E)	Tax Share (S)	Efficiency (E)	Tax Share (S)
18	.96	.45	.97	.56
24	.97	.54	.98	.60
30	.97	.57	.97	.62
36	.97	.60	.97	.64
42	.97	.62	.96	.65
48	.97	.63	.96	.66
60	.98	.65	.98	.66
72	.98	.65	.98	.67

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3. The Economic Impact of Uranium Mining in Saskatchewan

3 (i) Introduction

This section presents a forecast of Saskatchewan's uranium production and an estimate of the impact of the industry on gross domestic provincial product and employment. A survey of Canada's uranium reserves indicates that Saskatchewan is likely to have the bulk of the nation's low cost resources. While availability of reserves is unlikely to be a factor limiting output in the near future there are some aspects of federal and provincial government policy which will tend to restrict the size of the industry. In particular, the federal concern to ensure adequate domestic supplies and to restrict the uses of Canadian uranium to peaceful purposes, and the provincial government's desire for sustainable economic development in northern Saskatchewan will limit the growth of the industry. A policy which is shared by both federal and provincial governm is that of attempting to maintain uranium prices and this will tend to restrict Canadian exports. Given these policy objectives and the state of the world uranium market a relatively modest forecast of Saskatchewan's uranium production seems to be justified. This forecast is used as the basis of a set of estimates of the contribution of the uranium mining industry to economic growth in Saskatchewan. Since the forecast is extremely speculative the estimates of the impact of the uranium mining industry should be regarded as illustrative in nature.

3 (ii) Reserves

The two principal regions in which Canada' uranium reserves are located are the Elliot Lake region of Ontario (about 60% of reserves in 1980) and the extreme north of Saskatchewan (about 31%). Saskatchewan's share of both reserves and production (about 34% in 1980) is likely to rise significantly in the next two decades because of the relatively low cost nature of the province's uranium resources. In 1980 60% of Canada's uranium exploration expenditures were incurred in Saskatchewan, reflecting the industry's belief that substantial additions to reserves which are mineable at low cost will be made in that province. Some of the recently discovered deposits in Saskatchewan are already in or about to start production using low-cost open-pit mining techniques and the entry of these mines to the industry will raise the province's share of Canadian production to over 50% by the mid-1980's. It seems safe to conclude that Saskatchewan's uranium mining industry will become an increasing proportion of the Canadian industry over the next quarter century.

Factors of importance in determining the development costs of a uranium mine are the grade and configuration of the deposit and the depth at which it occurs. For depths up to 500 feet relatively low-cost open-pit mining techniques can be used whereas deposits at greater depths require more expensive underground mining as in the Elliot Lake region. Thus Rio Algom's and Dennison's production costs at Elliot Lake are estimated to be \$54 and \$60/kg U respectively in 1979 whereas the cost of production at Key Lake will be under \$30/kg U in 1979 dollars. Despite the higher costs of production in Ontario the federal government has indicated that it wishes to maintain the industry in the Elliot Lake region. Furthermore the two remaining producers have the bulk of their production committed in contracts with Ontario Hydro until the second decade of the 21st century.

Within Saskatchewan there are two main uranium bearing areas. The Beave lodge District north of Lake Athabasca has had several uranium mines, the last of which was operated by Eldorado Nuclear Limited and was closed in mid-1982. The Athabasca Sandstone Basin south of and underlying Lake Athabasca contains substantial uranium reserves. The deposits associated with the Athabasca Basin are generally located at the point of contact of the sandstone with the Precambrian basement. Initial exploration of the Basin focussed on its margins where the contact between the formation and the basement is close to the surface. This resulted in the discovery of several open-pit mining prospects such as Cluff Lake, Key Lake, Rabbit Lake, and the Collins Bay deposits. The geology of the Athabasca Basin and the history of its exploration is very similar to the Alligator Rivers area in the Northern Territory of Australia where open-pit prospects such as the Ranger deposits have been located. Subsequent exploration of the interior of the Athabasca Basin has resulted in the discovery of deposits such as Midwest Lake, Dawn Lake and Waterbury Lake which lie at depths of over 500 feet at the contact between the floor of the Basin and the basement roc

Estimated uranium reserves at the Cluff Lake, Rabbit Lake - Collins Bay, and Key Lake mines are around 130,000 metric tons of uranium which is almost 20 years' supply at planned production rates. The Cluff Lake 'D' and Rabbit Lake deposits are already exhausted. Additional sales could be met from one of around 10 other deposits which are at an advanced state of exploratory and pre-development work. These deposits tend to form a queue for the opportunity to extract, the places in the queue mainly reflecting production costs. As new discoveries are made and investigated the order of the deposits in the queue changes in accordance with the economic principle that low-cost deposits will be exploited first; thus the relatively shallow McLean Lake deposit has probably overtaken the deeper Midwest Lake deposit for which a preliminary environmental impact statement had been filed prior to the recent softening of the uranium market but which has now been deferred at least 5 years. The weak uranium market together with the province's substantial reserves have led to a decline in uranium exploration expenditures in Saskatchewan from $77 million in 1980 to around $40 million in 1982.

To conclude this section it is unlikely that availability of reserves will limit Saskatchewan's uranium production in the foreseeable future. Indeed the prospects for continued supplies of low-cost uranium are such that Saskatchewan is likely to supply the bulk of any increases in Canada's uranium output over the next twenty years. Ontario's output is unlikely to rise significantly above the 5000 - 6000 tonnes U range and given the low levels of exploration expenditures there is little prospect of an increase in mineable reserves at forecast prices. As the following statistics on the distribution of uranium exploration expenditures in 1980 show, it is only in the NWT that significant additions to reserves are likely and development there is likely to be delayed by unsettled native land claims:

Table 3.1: Uranium Exploration Expenditures by Province (1980) (%)

Sask	NWT	Quebec	NS	Nfld	Ont	NB	Yuk	Man	Alta	BC
60	23	5	4	3	1	1	1	1	1	-

(Source: Uranium in Canada: 1980 Assessment of Supply and Requirements)

Thus it seems likely that Canada's uranium industry will be increasingly dominated by Saskatchewan for the rest of the century.

3 (iii) Restrictions on Development Imposed by Government Policy

There is a range of goals of government policy which would be served by restricting uranium output to a level below that which would appear to be justified by market demand and the availability of reserves. One objective is to maintain or raise the price of uranium and this is discussed in the following subsection dealing with the uranium cartel. In the present subsection various objectives of federal and provincial policy are discussed which are likely to result in limitation on output.

There are a number of general objectives of Canadian mineral policy which are common to all minerals: to ensure adequate domestic supplies; to accumulate information on reserves; to realize opportunities for further processing; to increase the return to Canadians from exportable surpluses; and to contribute to orderly world mineral development and marketing. In the case of the uranium industry an additional objective of national policy is that exports be used for peaceful purposes only. Federal policy on uranium is implemented by the Uranium Export Review Panel which may recommend that the Minister withold approval of uranium export contracts.

The objectives of increasing the return to Canadians and contributing to "orderly" marketing are advanced by witholding supplies in concert with other major producers. A further dimension of this policy is the need to ensure that, given the amount of foreign ownership of the uranium industry, transfer pricing is eliminated. The objective of maintaining adequate domestic supplies is pursued by estimating domestic requirements for the next 30 years and sharing responsibility for meeting these requirements among producers in proportion to reserves. Each producer's uncommitted uranium resources must be sufficient to meet its share of domestic requirements otherwise export contracts will not be approved. A further restriction is that export contract approvals are limited to 15 years from date of signing. Since contracts are often entered into during the development state of a mine a contract may cover only 10 - 12 years of uranium supply which is not an overly long period in a market in which security of supply is the buyer's main concern. These provisions of the policy of maintaining adequate domestic supply are currently under review and are likely to be relaxed. Canada's uranium processing industry is still being developed and expanded. It will consist of a plant at Blind River, Ontario, which will have the capacity to convert U_3O_8 to UO_3 at a rate of 18,000 tonnes U. per year. The UO_3 will then be shipped to the processing plant at Port Hope which will be able to convert UO_3 to UF_6 for export at a rate of 9,000 tonnes U. per year and also to produce UO_2 for use by Candu reactors. Since the capacity of the domestic processing industry is likely to exceed domestic production for some considerable time to come the implication of federal policy is that all domestic production in the next ten years or so will be routed initially to Blind River. Canada's policy of attempting to restrict the use of its uranium to peaceful purposes has resulted in embargoes on exports to the EEC, Switzerland, Japan and Spain. Currently Switzerland and Spain are still not receiving Canadian uranium.

It is clear that federal policy tends to operate in the direction of reducing uranium exports. Higher prices and security of domestic supply can be achieved by restricting exports although in practice domestic reserves and production are so far in excess of domestic needs that the domestic supply constraint is not binding although it is possible that restrictions on sales contract terms make Canadian uranium less attractive to foreign buyers. To the extent that domestic processing costs are higher than those in the consuming countries the domestic processing policy tends to reduce the price received by producers for U_3O_8 and to lower output. The policy of attempting to restrict the use of Canadian uranium for peaceful purposes by means of embargoes tends to increase the probability of an interruption in supply to the buyer and tends to make Canadian uranium less competitive in the world market. It should be stressed that while federal policy tends to reduce uranium exports the magnitude of the effect of each policy measure, with the exception of the policy of maintaining uranium prices, has probably been slight. It is difficult to guage the extent to which federal policy has reduced exports in an effort to maintain price because the restrictions tend to operate in informal as well as formal ways.

Since provincial tax receipts are extremely sensitive to uranium price the government of Saskatchewan shares the federal government's interest in restricting supply to maintain price. The provincial government has other policy concerns which are served by restricting the rate of development of the industry. The two most important of these are the desire to avoid environmental degradation and the desire to promote orderly social and economic development in the province particularly in northern Saskatchewan.

The environmental and health problems associated with uranium mining have been the subject of a number of enquiries the most prominent of which in recent times have been the Ranger Uranium Environmental Inquiry in Australia and the Cluff Lake Board of Inquiry in Saskatchewan. Two principal recommendations of these exhaustive and comprehensive reviews of the uranium mining issue were the following: that the fragile environment in the locality of the mine be protected and that additional baseline data on the likely dispersion and effects of heavy metals and other pollutants on water and atmospheric systems be collected; and that full opportunity be given to local residents and in particular to aborigines or native indians to participate in the economic activity associated with the mine while at the same time extreme care be taken to ensure that local residents do not suffer social or economic deprivation. Both the Fox and Bayda commissions held that these policy goals could be served by a policy of sequential development of uranium mines and mills in the region. This is a policy which has been termed one of attenuated mineral development.

The two principal advantages of the policy of attenuation are that the impact of the industry at any point in time on the local economy, environment, and social structure is lessened, and that an industry exploiting an exhaustible resource has a longer life. A smaller impact is of particular advantage when a policy goal is to involve local individuals and firms in supplying services to the mining firms. A large industry consisting of many mines would have to be supplied mainly from outside the region whereas an industry consisting of a few mines at any one time would provide a basis for continuing employment of a group of local individuals and firms. The longer life of the attenuated industry provides an opportunity for "learning-by-doing". As a result of the operations of the first few mines in the sequence a group of experienced workers and firms develops which can be drawn on by subsequent mines. While the first uranium mines and mills in the sequence of projects may be equipped with best practice techniques for environmental protection it is likely that pollution will occur because of unforeseen circumstances. The attenuated industry, however, is unlikely to inflict irreparable damage on the regional environment because of its reduced scale, and the experience of earlier mines can be incorporated in the design and operating procedures of subsequent ones. While an attenuated industry confers benefits on the local economy, society, and environment, the postponement of individual mining projects does have a cost and this aspect is discussed in the literature.

It is evident from the terms of the surface leases of the three new mines which have received approval to date that the government of Saskatchewan has placed considerable emphasis on local involvement in the uranium mining industry. For e ample, among the terms of the Key Lake surface lease are that at least 50% of mine and mill staff should be northerners and that a fly-in programme be used to attract labour from existing northern communities. The Cluff Lake lease had a requirement that 50% of employees in the operating phase of the mine be native indians. The Key Lake lease also offers local business a 10% preference in bidding for contracts with the mining firms. This preferences will have its biggest impact during a mine's construction phase. For example, in the period August 1981 - December 1982 northern businesses obtained 20 contracts valued at $40.09 million or 49% of the value of contracts let for the construction of the Key Lake project. Because of its size and scope, however, the economy of northern Saskatchewan can support only a small number of mines without substantial recourse to outside labour and contractors. It follows that maximum involvement of northerners will be achieved by an attenuated industry and this is the course of development implied by the objectives of recent provincial policy.

The Cluff Lake and Key Lake Boards of Inquiry paid a considerable amount of attention to environmental problems associated with uranium mining. The terms of the Key Lake surface lease reflects this concern in that it imposes stringent conditions on the design and operations of the proposed mine and on the plans for reclaiming the site after extraction is completed. There is little evidence that the inquiries saw any notable advantage in terms of environmental protection to be gained from the reduced impact of an attenuated industry. On the other hand, it is likely that the increased opportunity for "learning-by-doing" afforded by sequential development did not escape the commissioners' attenuation. It is certainly the case that the time consuming process of gathering evidence on and deliberating over issues of environmental protection has effectively attenuated the earlier stage of the industry's development. As the learning process continues the amount of time necessary for investigating proposals for new mines is likely to decrease. Nonetheless it is to be expected that a policy of gradual development will continue to be followed.

3 (iv) The Uranium Cart l

In 1972 a urani marketing cartel called the Uranium Marketing Research Organization (UM) was formed to regulate the marketing of uranium in the non-communist world e luding the United States. The cartel members were the governments of Canada and ustralia and the major uranium producing companies in these countries, Nufcor a Uranex, which are the corporations with government participation through whi all sales of South African and French uranium are made, and Rio Tinto Zinc. The rtel agreed on quotas dividing the free world uranium market among its members, n uranium sales prices, and on a system of rigged bidding for supply contracts desi ed to ensure that members' quotas were filled at an even rate. The Canadian d Australian governments were to use the export licensing system to ensure that dom tic companies observed the cartel rules, and the South African and French governm nts were to use their considerable influence on their country's marketing corpor tions.

In the period 197 -1974 in which the cartel is generally conceded to have operated the cartel f or price rose from $5.50 to $14.50 per lb U_3O_8 while the Nuexco US spot price r e from $6 to $14.50. Subsequently the spot price rose to a high of almost $44 pe lb in 1979. There have been a number of explanations besides the influence of t cartel for this dramatic price rise. The principal explanations app r to be a change in 1972 in the U.S. Atomic Energy Commission's enrichment po cy in the direction of substituting U_3O_8 for energy in preparing enriched fuel the 1975 default of Westinghouse, a principal dealer in the uranium market, on ntracts to supply 49 reactors with fuel, and the 1979 rise in the price of OPEC 1. Westinghouse blamed its inability to meet its contracts on the activities f the cartel in raising uranium prices. While the cartel was not fully responsible r the large increase in price which occurred in the 1970's it is clear that a marketi organization which controlled over one third of low-cost onably assured reserves could have considerable influence on price.

It is difficult to judge whether Canada is still colluding with the other large producers (apart from the U.S.) because restricting uranium output is consistent with other aims of government policy which were discussed above. Evidence that output will be restricted in order to maintain prices consists of the fact that this was federal government policy in the early 1970's and the federal government continues to maintain tight control of the terms of any new sales contract through its Uranium Export Review Panel. The government of Saskatchewan has attempted by various means to restrict the province's output of potash in order to maintain prices and there have been statements by government officials to the effect that development of uranium mines should not be allowed to proceed at a pace which would undermine the market. This philosophy has also been expressed by the Chairman of the Uranium Export Office in Australia and it seems likely that Canada and Australia will avoid price competition with one another.

If collusion does take place the price which operators of the new open-pit mines in Saskatchewan will receive for their uranium will be above the production cost of around $30/kg. U in 1979 dollars. The limiting price will probably be that at which U.S. requirements can be met by domestic sources. Industry analysts tend to agree that adequate supplies from the domestic industry should be forthcoming at least until 1990 without cost rising above $30/lb U_3O_8 (about $78/kg. U). This means that Saskatchewan's low-cost uranium can be sold at a price of $30/lb U_3O_8 at least until 1990 without suffering significant competition from the large U.S. uranium mining industry. The same conclusion has apparently been reached by the Australian government which has set a floor price of $30/lb U_3O_8 (1980 US dollars) below which it will not allow Australian uranium to be sold.

Any forecast of uranium prices beyond 1990 is obviously extremely speculative, but it can be noted that, provided those reserves in the category mineable at a uranium price up to $130/kg U. are increased by 35% over the period 1980-2020, the forecasted Canadian cumulative output of 825,000 tonnes U can be produced at a cost up to $130/kg U.

3 (v) The World Uranium Market and Canadian Production

In the four years 1979-1982 the price at which transactions in the uranium market were made fell from \$42.50/lb U_3O_8 to \$17.00/lb U_3O_8 according to NUEXCO estimates. Despite this extreme volatility medium-term projections of uranium supply and demand are relatively easy to make. Since both demanders and suppliers are commiting large amounts of capital well in advance (8-10 years) of deliveries there is a considerable amount of risk involved and an attempt is generally made to reduce this by means of long-term contracts (85-90% of the market) which assure buyers and sellers of being able to make transactions within some predetermined price range. This means that production over the next 8-10 years from existing and planned mines can be forecasted with a reasonable degree of certainty. The following Table reports estimates of Canadian uranium production by province:

Table 3.2: Estimated Canadian Uranium Production (tonnes U p.a.)

Year	Ontario	Saskatchewan	Total
1981	5,100	3,400	8,500
1982	5,100	3,400	8,500
1983	5,100	3,900	9,000
1984	5,800	7,000	12,800
1985	5,800	7,000	12,800
1986	5,700	7,000	12,700
1987	5,600	8,700	14,300
1988	5,500	8,700	14,200
1989	5,400	8,700	14,100
1990	5,100	8,700	13,800

(Source: O.J.C. Runnalls Ontario's Uranium Mining Industry - Past, Present and Future)

In order to predict uranium production o r the longer term it is necessary to forecast domestic and world demand a l supply. It is forecasted that Ontario Hydro will account for almost all th domestic demand for uranium until 1995. Thereafter demand for uranium by Que c Hydro and the New Bunswick Electric Power Commission may constitute a more s nificant portion of domestic demand depending on the availability of alternati sources of energy. Other provinces may also decide to establish nuclear po r plants. Since Ontario producers have extensive commitments to supply On rio Hydro until 2011 (Dennison) and 2020 (Rio Algom) a reasonable assumption for recasting purposes might be that domestic demand can and will be met out of O ario's uranium production and that sales of Saskatchewan uranium will depend on xport demand.

The estimation of world uranium demand b ond the period during which currently commissioned reactors will become opera onal is fraught with three principal uncertainties; first, it is difficult, pecially in the light of recent experience, to predict the growth of elect city demand; secondly, in view of the problems experienced by operating nucl ar plants and the delays associated with licensing and constructing new pl ts it is difficult to forecast the proportion of electricity demand which will be generated by nuclear power; and, thirdly, uncertainty about the type of nucle fuel cycle to be used in the future can lead to wide variations in predictions f uranium demand. The following list of uranium demand estimates illust tes the effect of these uncertainties. Each forecast consists of a range of es imates, of which only the lowest and highest are reported here, contingent the assumptions made in the three areas mentioned above. The wide range of es imates in each forecast and the considerable disparity among forecasts suggest that little confidence can

Alternative Forecasts of World*
Uranium Demand, 1995-2020

			Years			
Forecast			1995	2000	2010	2020
			(thousands of tonnes U)			
WEC[1]	(1978)	low	-	190	-	350
		high	-	220	-	600
OECD[2]	(1977)	low	104	125	-	-
		high	234	338	-	-
OECD[3]	(1982)	low	64	81	54	55
		high	93	129	178	317
Uranium[4]	(1981)	low	65	-	-	-
Institute		high	108	-	-	-

(Sources: 1. Canada, Energy Mines and Resources (1978)
2,3 OECD (1977, 1982)
4 Uranium Institute (1981)

*World excluding the USSR, Eastern Europe, and China

be placed in any particular set of estimates. Nevertheless, for the purposes of this study it is necessary to have a forecast of uranium demand and the one selected is the World Energy Conference's (WEC) low estimate of 190,000 tonnes in 2000 and 350,000 tonnes in 2020. While this is at the low end of the range of WEC estimates it is at the high end of the range of forecasts cited. Since almost all the impact estimates which are reported in this study are linearly related to uranium demand it is an easy matter for the reader to calculate the impact of the industry under alternative assumptions about demand and production.

Based on estimates of uranium resources prepared by WEC, OECD, and Energy, Mines and Resources, Canada, Canada's share of the world's reasonably assured uranium resources recoverable at costs up to $130/kg U is around 10%. The 10% share in the world uranium market assigned to Canada in the forecast of production to 2020 is substantially less than Canada's 20% share in world production in 1978. By 1990 Canada's share is predicted to fall to 13% and to decline even further in the 1990's. There are two main reasons for predicting a decline. First, the United States which ranks first in the world in terms of what are called low-cost (up to $130/kg. U) reasonably assured uranium resources has indicated its readiness to protect its uranium producing industry against foreign competition if necessary. This means that Canadian producers may have a declining share of the expanding U.S. market. Secondly, since South Africa and Australia have become the first and second ranked countries after the United States in terms of low-cost reasonably assured resources they can be expected to increase their share of the world market. This is especially true in the case of Australia which has recently seen substantial increases in its reserves to about 14% of low-cost reasonably assured resources but which currently has only about 6% of world uranium production. Evidence of Australia's ability to expand its share of the market is that since 1980 it has secured a larger tonnage of export contracts than Canada.

If Canada were to fill 10% of world demand as estimated by the WEC it would require to produce 19,000 tonnes U p.a. by 2000 and 35,000 tonnes U p.a. by 2020. Given current estimates of reserves it is likely that Saskatchewan will have a substantial share of the Canadian industry by 2000. A reasonable ssumption might be that Ontario's production will be maintained at the forecasted level for 1990 and that Saskatchewan will account for the rest of Canada's production. This means that Saskatchewan would produce 14,000 tonnes U in the year 2000, about 75% of the country's total output. By the year 2000 exploration in other parts of Canada, in the Northwest Territories for example, will probably have located additional low-cost uranium reserves. The development of these reserves will result in a decline in Saskatchewan's share of Canadian production and for the purposes of the present study it will be assumed that this share stands at 50% in the year 2020.

To review the implications of these forecasts, Saskatchewan's production is forecasted to rise to 8,700 tonnes U p.a. in 1990, as indicated by the Table of estimates and then to rise linearly to 14,000 tonnes U. p.a. in the year 2000. After 2000, Canada's output is forecasted to rise linearly to 35,000 tonnes p.a. in 2020, with Saskatchewan's share falling linearly from 75% in 2000 to 50% in 2020. The following Table reports the forecasts of Canadian and Saskatchewan output.

Table 3.3: Forecast of Annual Uranium Output of Saskatchewan and Canada, 1981-2020

Year	Output		Year	Output	
	Saskatchewan tonnes U. pa	Canada tonnes U.pa		Saskatchewan tonnes U. pa	Canada tonnes U. pa
1981	3,400	8,500	2001	14,226	19,800
1982	3,400	8,500	2002	14,564	20,600
1983	3,900	9,000	2003	14,969	21,400
1984	7,000	12,800	2004	15,185	22,200
1985	7,000	12,800	2005	15,468	23,000
1986	7,000	12,700	2006	15,732	23,800
1987	8,700	14,300	2007	15,978	24,600
1988	8,700	14,200	2008	16,205	25,400
1989	8,700	14,100	2009	16,414	26,200
1990	8,700	13,800	2010	16,605	27,000
1991	9,220	14,320	2011	16,777	27,800
1992	9,740	14,840	2012	16,931	28,600
1993	10,260	15,360	2013	17,067	29,400
1994	10,780	15,880	2014	17,184	30,200
1995	11,300	16,400	2015	17,283	31,000
1996	11,820	16,920	2016	17,363	31,800
1997	12,340	17,440	2017	17,425	32,600
1998	12,860	17,960	2018	17,468	33,400
1999	13,380	18,480	2019	17,493	34,200
2000	13,900	19,000	2020	17,500	35,000
Cumulative	182,100	287,300		327,837	548,000

These estimates of uranium output involve cumulative Canadian production of 287,300 tonnes U by 2000 and 835,300 tonnes U by 2020. These cumulative production figures can be compared with 1979 estimates of Canadian reserves in the measured, indicated, inferred and prognosticated categories mineable at uranium prices up to $130/kg. U of 671,000 tonnes, and additional reserves mineable at prices up to $200/kg. U of 348,000 tonnes U. Since exploration will probably result in an increase in reserves mineable at prices up to $130/kg. U it is probably safe to assume that production costs in Canada in the year 2020 will be less than $130/kg. U(1979 dollars)in real terms. The bulk of current Canadian uranium exploration is taking place in Saskatchewan and a significant increase in that province's reserves can be anticipated. Saskatchewan's current reserves are estimated to be about one third of Canadian reserves which would constitute about 204,000 tonnes mineable at prices up to $130/kg. U and 116,000 tonnes mineable at prices up to $200/kg. U. In terms of the forecast of Saskatchewan production all the forecasted output to the year 2000 can be met out of existing reserves in the low-cost category. Thereafter discoveries corresponding to 160% of existing low-cost reserves will be necessary to maintain production at a cost below $130/kg. U (1979 dollars) in real terms.

In the absence of a formal model it is difficult to estimate the amount of exploration which will be required to produce the additions to provincial reserves described above. The standard model of reserves production from a new exploration territory such as the Athabasca basin would predict that for a constant level of exploratory effort annual additions to reserves would increase at first, reflecting the contribution of additional knowledge about the geology of the region, and then decrease once the larger and more easily-located deposits had been located. Since this pattern of discovery would not be inconsistent with the production estimates and current reserve information reported above it will be assumed that uranium exploration expenditures in Saskatchewan remain at $50 million (1980 dollars) per annum in real terms throughout the forecast period. This is slightly above the average level of expenditures during the period 1977-82 which saw annual expenditures rise from $40 million in 1977 to $77 million in 1980 and then fall to $45 million in 1982.

The forecasts of world uranium demand which have been discussed here are made with no reference to uranium price. Since the demand for uranium is derived from the demand for electric power and since uranium fuel costs are a very small proportion of the cost of generating electricity by nuclear means the long-run demand curve for uranium is likely to be fairly inelastic. This means that quantity demanded will not vary much with price and this justifies to some extent forecasts of demand which take no account of price. On the other hand, the price of uranium will be sensitive to the quantity supplied and this raises the possibility that concerted action to reduce supply could result in significant resource rents accruing to suppliers. In the case of Saskatchewan uranium a large proportion of resource rents accrues to the provincial government through its uranium royalties scheme. Since these rents may be used to finance economic development in the province it is important in the present study to come to view about future uranium prices as well as production.

It was argued earlier that a price of around $78/kg. U (30/lb U_3O_8) represent a price at which U.S. and high-cost Canadian producers can easily cover costs. The aim of the low-cost Canadian and Australian producers will be to maintain price at close to this level thereby collecting substantial rents. For the purposes of the present study it will be assumed that the price of uranium is $70/kg. U (1980 dollars) in real terms until the year 2000. This represents a price of around $27/lb U_3O_8 which is slightly higher than the current price. As production continues beyond the year 2000 real price of uranium will rise reflecting cost increases among the high cost producers. It will be assumed that the price is $100/kg. U (1980 dollars) in real terms from 2000-2020. The price of $70/kg. U yields a rent of $40/kg. U to the Key Lake operation while the price of $100/kg. U is roughly double the current cost of production in Ontario.

3 (vi) The Impact of Uranium Production on the Economy of Saskatchewan

The Saskatchewan uranium industry will have direct and indirect effects on the provincial economy. The direct effects consist of the employment and income impacts generated within the industry itself while the indirect effects consist of employment and income generated in other industries as a result of the linkages between the uranium industry and the rest of the economy. There are three kinds of linkages which are normally considered in an estimation of the indirect impact of an industry: the effects on industries which supply inputs to the industry in question are termed backward linkages; the effects on industries which demand the output of the industry in question are termed forward linkages; and the effects of complementary developments such as mining towns are termed sideways linkages. In the present study backwards linkages alone are considered. The forward linkages will be felt mainly in Ontario where the uranium processing industry is located and the sideways linkages are likely to be small because of the provincial government's "fly-in" policy under which employees will be flown into the mine sites from established communities.

The three kinds of expenditures undertaken by the uranium mining industry which will have backward linkages with the provincial economy are exploration expenditures, expenditures associated with mine and mill development, and expenditures associated with mine and mill operation. In section 3(v) a figure of $50 million (1980 dollars) was adopted as the estimate of annual exploration expenditures. Table 3.3 reported estimates of the annual outputs of uranium resulting from mine and mill operation over the period 1981-2020. Mine and mill development expenditures sufficient to sustain those levels of uranium output over that period will have to be incurred. New mine/mill complexes will be required to provide increments to industry capacity and to replace mines which become exhausted. Since uranium mines have an average life of around 12 years some 40,000 tonnes of uranium producing capacity will have to be installed in the years 1981-2020 to meet the estimate of cumulative production reported in Table 3.3. It was suggested in section 3(iii) that an objective of provincial policy was to maintain a stable construction industry based on mine and mill development. This would imply that approximately 1,000 tonnes of uranium producing capacity would be constructed in each year from 1981 to 2020 and this is the assumption which will be adopted in the estimates of backward linkages.

The magnitude of backward linkages on the provincial economy is measured using multipliers derived from the inter-provincial input-output table. There are two kinds of multipliers in general use: multiplier type A can be defined as the ratio of change in provincial income to change in the value of industry output; type B can be defined as the ratio of change in provincial income to change in industry value added. Since the change in industry output is almost always larger than the change in value added, type B multipliers are larger than type A but the forecasts of industry impact should be the same. In the present study type B multipliers will be used. This means that estimates of the cost-breakdowns for the various industry expenditures are required to provide the base for the multiplier calculation. Measures of backward linkages derived from multipliers are virtually certain to represent upper-bound estimates of the direct and indirect effects of the industry on extensive growth. They also offer no insights regarding the contribution of backward linkages to intensive growth in Saskatchewan. The reason is that the use of multipliers assumes that supplies of labour, capital and intermediate inputs are available at constant factor prices and are not currently employed in the Saskatchewan economy. To the extent, for example, that the backward linkages of the uranium industry lead to an internal reallocation of factors within the provincial economy there is no extensive growth in the province. Or if the backward linkages are satisfied by attracting labour from elsewhere in Canada the extensive growth of Saskatchewan corresponds to a contraction elsewhere in Canada. In either of these two cases, mobile factors are merely being reallocated at constant factor prices so that there is no net impact on income per capita. Only if the factors use unemployed and in Saskatchewan would intensive growth increase in the province as a result of the backward linkages.

Table 3.4: Income and Employment Impact of Uranium Exploration in Saskatchewan

Income Impact (millions of 1980 dollars)		Employment Impact (jobs)	
Annual Expenditure	= 50		
Provincial Value Added	= 34.5	Direct	= 1144
Multiplier	= 1.34	Multiplier	= 1.39
Total Annual Impact	= 46.23	Total	= 1590

(Source: derived from Marvin Shaffer and Associates Ltd (1982), pp. 54 - 55)

It is estimated that the capital cost of a typical open-pit uranium mine and mill is around $110 million per thousand tonnes of metal output capacity. Of this sum, construction labour accounts for around 22% and equipment, materials and services the remaining 78%. The construction labour input is estimated to be around 600 man-years per thousand tonnes of capacity. Using these figures the following estimates of the impact on the provincial economy of the construction of one thousand tonnes of uranium producing capacity can be obtained.

Table 3.5: Income and Employment Impact of Investment in Uranium Production Capacity in Saskatchewan

	Income Impact ($ millions)		Employment Impact (jobs)
Annual Capacity Constructed	= 1000 tonnes		
Provincial Value Added	= 24.2	Direct	= 600
Multiplier	= 2.5	Multiplier	= 3
Total Annual Impact	= 60.5	Total	= 1800

(Source: Marvin Shaffer and Associates Ltd (1980))

The provincial value-added component of a dollar's worth of uranium metal is highly sensitive to the price of uranium. Two price levels are considered in the present study. Until 2000 the price is assumed to be $70/kg. U (1980 dollars), and from 2000-2020 to be $100/kg. U (1980 dollars). The following Table reports estimates of the operating cost structure of an open-pit uranium mine and mill in Saskatchewan under each of these price assumptions:

Table 3.6: Operating Costs per Kilogram of Uranium Output for an open-pit mine in Saskatchewan

Input Cost	1980 $	
	Price = $70	Price = $100
Material and Service Costs	5.81	6.10
Gross (pre-tax) Labour Cost	4.13	5.50
Government Revenue		
- federal corporate income tax	12.32	15.30
- provincial corporate income tax	4.48	5.20
- provincial royalty	16.10	29.80
Gross Operator Margin	27.16	38.10
Total Unit Value (f.o.b. Mill)	70.00	100.00

(Source: Marvin Shaffer and Associates Ltd (1980), Table 3.1 and 3.2)

It can be seen from Table 3.6 that provincial value added, which is the sum of all input costs except material and service costs is highly sensitive to uranium price. Since provincial value added plays a critical role in determining the overall economic impact it is clear that the uranium price assumption is a critical one in the impact estimates. For the present the impact calculations will be carried out on the assumption that provincial government receipts, which are the largest component of value added (see Table 3.10), are disposed of in a way which involves no impact on the provincial economy. This assumption will be relaxed later.

The annual economic impact of operating a facility producing 1,000 tonnes U per annum for the two prices under consideration is reported in the following Table:

Table 3.7: Annual Economic Impact of Operating 1,000 tonnes U p.a. Capacity

(millions of 1980 $)

Price = $70/kg. U		Price = $100/kg. U	
Provincial Value Added	= 64.2	Provincial Value Added	= 93.9
Multiplier	= 1.04	Multiplier	= 1.04
Total Annual Impact	= 56.6	Total Annual Impact	= 97.4

(Source: derived from Marvin Shaffer and Associates Ltd. (1980) Chapters 3 and 4)

The annual employment impact of operating a 1,000 tonnes U per annum plant is given by the following Table:

Table 3.8: Employment Created by Operating 1,000 tonnes U p.a. Capacity

		(jobs)
Direct impact	=	225
Multiplier	=	1.49
Total	=	335

(Source: Marvin Shaffer and Associates Ltd (1980, Table 4.3)

The annual impacts of the exploration, development and production activities associated with the uranium mining industry are summarized in Table 3.9. The contributions to gross domestic provincial product are calculated from the impacts reported in Tables 3.4, 3.5 and 3.7 together with the annual uranium production estimates reported in Table 3.3. The employment impacts are estimated from Tables 3.4, 3.5 and 3.8 together with the production figures of Table 3.3. To place the impact estimates in perspective it is helpful to compare them with current levels of production and employment in the province. The following Table shows the uranium industry's forecasted contributions to gross domestic provincial product and employment for selected years as percentages of 1980 provincial product and employment levels. This procedure adopted for Table 3.10 (and 3.18 to follow) assumes no growth in the Saskatchewan and national economies other than from the province's uranium industry.

Table 3.10: Impacts of Saskatchewan's Uranium Industry Expressed as Percentages of 1980 Product and Employment Levels

Year	Contribution to GDPP / 1980 GDPP	Employment / Total Mining Employment	Employment / Total Non-Agricultural Employment
	%	%	%
1981	2.54	52	1.7
1990	5.24	72	2.3
2000	7.90	92	2.9
2001	11.41	93	3.0
2010	13.20	103	3.3
2020	13.87	106	3.4

(Sources: Statistics Canada 13-213 and 72-008, and Table 3.9)

Table 3.9: Estimated Annual Impact of Saskatchewan's Uranium Industry on the Provincial Economy

	Contribution to GDPP (millions 1980$)				Contribution to Provincial Employment (Jobs)			
Year	Explor'n	Develop't	Prod'n	Total	Explor'n	Develop't	Prod'n	Total
1981	46	61	226	333	1590	1,800	1,139	4529
1982	46	61	226	333	1590	1,800	1,139	4529
1983	46	61	260	367	1590	1,800	1,307	4697
1984	46	61	466	573	1590	1,800	2,345	5735
1985	46	61	466	573	1590	1,800	2,345	5735
1986	46	61	466	573	1590	1,800	2,345	5735
1987	46	61	579	686	1590	1,800	2,915	6305
1988	46	61	579	686	1590	1,800	2,915	6305
1989	46	61	579	686	1590	1,800	2,915	6305
1990	46	61	579	686	1590	1,800	2,915	6305
1991	46	61	614	721	1590	1,800	3,089	6480
1992	46	61	649	756	1590	1,800	3,263	6653
1993	46	61	683	790	1590	1,800	3,437	6827
1994	46	61	718	825	1590	1,800	3,611	7001
1995	46	61	753	860	1590	1,800	3,786	7176
1996	46	61	787	894	1590	1,800	3,960	7350
1997	46	61	822	929	1590	1,800	4,134	7524
1998	46	61	856	963	1590	1,800	4,308	7698
1999	46	61	891	998	1590	1,800	4,482	7872
2000	46	61	926	1,033	1590	1,800	4,657	8047
2001	46	61	1,386	1,493	1590	1,800	4,766	8156
2002	46	61	1,419	1,526	1590	1,800	4,879	8269
2003	46	61	1,448	1,555	1590	1,800	5,016	8406
2004	46	61	1,479	1,586	1590	1,800	5,087	8477
2005	46	61	1,507	1,614	1590	1,800	5,182	8572
2006	46	61	1,532	1,639	1590	1,800	5,250	8640
2007	46	61	1,556	1,663	1590	1,800	5,353	8743
2008	46	61	1,578	1,685	1590	1,800	5,429	8819
2009	46	61	1,599	1,706	1590	1,800	5,499	8889
2010	46	61	1,617	1,724	1590	1,800	5,563	8953
2011	46	61	1,634	1,741	1590	1,800	5,620	9010
2012	46	61	1,649	1,756	1590	1,800	5,670	9062
2013	46	61	1,662	1,769	1590	1,800	5,717	9107
2014	46	61	1,674	1,781	1590	1,800	5,757	9147
2015	46	61	1,683	1,790	1590	1,800	5,790	9180
2016	46	61	1,691	1,798	1590	1,800	5,817	9207
2017	46	61	1,697	1,804	1590	1,800	5,837	9227
2018	46	61	1,701	1,808	1590	1,800	5,852	9242
2019	46	61	1,704	1,811	1590	1,800	5,860	9250
2020	46	61	1,705	1,812	1590	1,800	5,863	9253

It can be seen from Table 3.10 that the uranium industry's current contribution to gross domestic provincial product is estimated to be a relatively modest 2.54%. While the absolute contribution of the industry to GDPP increases almost sixfold over the period 1981-2020 a continuous growth rate of around 4.3% in GDPP would be enough to keep the industry's relative contribution to its current level. It can be seen that the percentage contribution increases considerably between 2000 and 2001 because this is the point at which the uranium price is assumed to increase from $70/kg. U to $100/kg U. In practice, of course, the price increase is likely to be a gradual one. As far as employment is concerned, the uranium industry is a significant part of the mining industry. Nonetheless direct and indirect employment generated by the uranium industry is forecasted to reach by 2020 a level of only 3.7% of non-agricultural employment in 1980.

Of course the accuracy of the estimates of economic impact presented above depends heavily upon the accuracy of the uranium output and price forecasts on which they are based. It should be emphasized once again that these forecasts are highly speculative and that the reader can readily adjust the impact estimates to accommodate alternative demand forecasts. Besides the questionable accuracy of the output and price forecasts there are some additional factors which may lead to error in the impact forecasts. First, it will be recalled that no attempt was made to account for complementary linkages such as the impact of producing additional transport,municipal and housing services in the north. Secondly, in view of the provincial government's emphasis on the participation of local businesses in the uranium industry it is possible that the direct impacts of the exploration, development, and production activities have been underestimated. This is particularly likely to be true in the case of mine and mill development. Thirdly, since a high proportion of the direct impact of the operating phase of a uranium mine/mill complex consists of tax revenue it is clear that the economic impact of uranium mining will be influenced considerably by the use to which these revenues are put.

The cost breakdowns reported in Table 3.6 were based on the Cluff Lake mine, in which the Saskatchewan Mining and Development Corporation (SMDC) has a 20% interest, and the Key Lake mine in which SMDC has a 50% interest. If it is assumed that the average SMDC interest is 35% then the proportion of the total value f.o.b. the mill of a kilogram of uranium which accrues to the provincial government can be calculated as follows:

Table 3.10: Provincial Government Receipts per Kilogram of Uranium Produced

	Price/kg. U (1980 $)	
	$70	$100
Provincial Corporate Income Tax	4.48	5.20
Provincial Royalty	16.10	29.80
SMDC Share of Gross Operator Margin	9.51	13.34
Total Provincial Receipts	30.08	48.34

These estimates of total provincial receipts per kilogram of uranium will understate future receipts if SMDC elects to acquire 50% of the equity in future developments as it was entitled to do under provincial legislation until recently when the requirement that a mining company had to allow SMDC to acquire up to 50% of its equity was abandoned. From Tables 3.3 and 3.10 the following estimates of provincial receipts for selected years can be obtained.

Table 3.11: Provincial Government Receipts from the Uranium Industry for Selected Years

Receipts (millions 1980 $)

Years	Income Tax	Royalty	SMDC	Total
1981	15	55	32	102
1990	39	140	83	262
2000	62	224	132	418
2001	74	424	190	688
2010	86	495	222	803
2020	91	522	233	846

The considerable jump in receipts between 2000 and 2001 is caused by the assumption that the higher price of uranium comes into effect in the latter year. Provincial royalty receipts are particularly sensitive to changes in uranium price.

Of the three categories of provincial receipts only the provincial royalties are classified as non-renewable resource revenues. The provincial share of corporate income tax is a tax on the earnings of physical capital the proceeds from which are allocated to general revenue. The revenues which accrue to SMDC are a return to investment in the uranium industry: SMDC purchases equity in discoveries by private companies and it conducts about half of the exploration for uranium in the province. The provincial royalty receipts are paid into the Saskatchewan Heritage Fund which also receives other non-renewable resource revenues. In the 1981-82 financial year uranium royalties totalling $30 million were paid into the fund. This is considerably less than the forecast figure of around $55 million because of the slump in the price of uranium in those years. The major contributor to the Heritage Fund at present is the oil industry which contributed 64% of 1981-82 revenues. The potash industry contributed 22% while the uranium industry's contribution was 3.6% of Fund revenues. The estimates in Table 3.11 indicate that by the year 2020 the uranium industry will be contributing $522 million (1980 dollars) per annum to the Heritage Fund. This is roughly equal to the 1981-82 contribution of the oil industry, and so, in a sense, the uranium industry will replace the declining oil industry.

Of the Heritage Fund revenues any proportion can be transferred as a dividend to the Consolidated Fund to help finance current government revenues. In 1981-82 a dividend of 70% of Fund revenues was paid. The remaining portion of revenue was used for provincial development expenditures (6 1/2%) incentive grants for the petroleum and natural gas industry (7%), and investment in various crown corporations including SMDC which is engaged in a programme of mineral exploration and mine development.

To this point in the study no attempt has been made to estimate the indirect effects of spending out of government revenue and operator margin. The implicit assumption made is that the appropriate multiplier for calculating the total effects of spending out of these receipts is unity. In fact this may not be a very inaccurate assumption as far as private profit margins and federal taxes are concerned since first round spending in Saskatchewan from these sources will be low. Where this assumption is likely to be particularly inaccurate is in the case of provincial receipts.

As indicated in Table 3.11 provincial government receipts from the uranium industry take three principal forms: the provincial corporate income taxes which accrue to the Consolidated Fund; the uranium royalties which accrue initially to the Heritage Fund but a portion of which is transferred in the form of a dividend to the Consolidated Fund; and SMDC's share of the private profit margin some of which is reinvested in the industry and some paid as a dividend to the Heritage Fund. Additions to the Consolidated Fund will be used to finance some combination of reducing taxes paid by Saskatchewan residents and increasing provincial government expenditures. The Heritage Fund revenues, net of those transferred to the Consolidated Fund, will be used to foster provincial economic development. The revenues accruing to SMDC, net of those transferred to the Heritage Fund, will be used further to develop the provincial mining industry: some of the expenditures which will be undertaken in this regard are included in the estimates of uranium exploration and development expense reported in Table 3.9; others will be of a more general nature. To the extent that SMDC finances exploration and development which would have been undertaken by the private sector it is simply transferring ownership of assets from the private to the public sector and this will involve no indirect economic impact. In summary, the indirect economic impacts which remain to be estimated are those associated with SMDC investment expenditures not already accounted for, expenditures out of the Heritage Fund, and the disposition of additions to the Consolidated Fund.

In order to generate some estimates of the magnitude of these additional indirect impacts the following assumptions will be adopted: first, that SMDC revenues will be divided equally among the Heritage Fund, expenditures already accounted for in Table 3.9, and further investment expenditures in the mineral industry; secondly, that 70% of Heritage Fund revenues will be transferred to the Consolidated Fund; and, thirdly, that of additions to the Consolidated Fund half will be used to finance tax cuts and half to finance increased levels of government expenditure. On the basis of these assumptions and using the estimates of receipts reported in Table 3.11, the following set of estimates of expenditures with indirect impacts which are not incorporated in Table 3.9 is obtained:

Table 3.12: Categories of Additional Government Expenditure Resulting from Uranium Receipts, Selected Years

	Uses of Funds (millions 1980$)		
Year	(1) Tax Reduction	(2) Increase in General Gov't Expenditure	(3) Gov't Development Expenditures
1981	30.5	30.5	31
1990	78.5	78.5	78
2000	125.0	125.0	124
2001	207.5	207.5	209
2010	242.0	242.0	245
2020	255.5	255.5	258

Each of these uses of funds will have an impact on the provincial economy not already accounted for in Table 3.9. Excluding the direct impact of these funds which is already accounted for the indirect impacts per $1,000 of expenditure can be estimated from the Interprovincial Input-Output model. The estimates reported in Table 3.13 are obtained from the inverse of the closed version of the provincial input-output model. They are likely to exaggerate the indirect impact of government spending on real GDPP for two reasons: first, the closed version of the input-output model makes no allowance for import leakages; and, second, the model assumes perfectly elastic factor supplies.

Table 3.13: Indirect Impacts of $1,000 Expenditure on Three Categories

Category	Indirect Impact ($)
Tax Reduction	283
Gov't Development Expenditure	685
General Gov't Expenditure	1,030

(Source: Gaston and Bédard (1980), Table III A8, Gross Domestic Product, Final Demand Categories - Transfers to Persons, Construction, and Government)

From Tables 3.12 and 3.13 the indirect impacts arising out of the allocation of provincial receipts can be estimated. These are reported in Table 3.14.

Table 3.14: Indirect Impacts of Government Expenditures, Selected Years

Impacts (millions 1980$)

Year	(1) Impact of Tax Reduction	(2) Impact of General Gov't Expenditure	(3) Impact of Gov't Development Expenditure	Total Impact
1981	9	31	21	61
1990	22	81	53	156
2000	35	129	85	249
2001	59	214	143	416
2010	68	249	168	485
2020	72	263	177	512

The Interprovincial Input-Output Model also allows the employment effects of increases in various categories of final demand to be estimated and these are reported in Table 3.15:

Table 3.15: Employment Effects of $10 million Expenditure on Three Categories

Category	Indirect Impact (person years)
Tax Reduction	175
Gov't Development Expenditure	291
General Gov't Expenditure	873

(Source: Gaston and Bédard (1980), Table III AB, Employment, Final Demand Categories - Transfers to Persons, Construction, and Government)

From Tables 3.12 and 3.15 the following estimates of the employment effects of government expenditure out of receipts from the urnaium mining industry can be calculated:

Table 3.16: Employment Effects of Government Expenditures, Selected Years

Impact (jobs)

Year	Impact of Tax Reduction	Impact of General Gov't Expenditure	Impact of Gov't Development Expenditure	Total Impact
1981	534	2,663	902	4,099
1990	1,374	6,853	2,270	10,497
2000	2,188	10,913	3,608	16,709
2001	3,631	18,115	6,082	27,828
2010	4,235	21,127	7,130	32,492
2020	4,471	22,305	7,508	34,284

In Table 3.17 the impacts of the industry's activity together with those of additional government expenditure are summarized for purposes of comparison. It can be seen that the indirect impacts of government spending out of receipts from the industry as a percentage of total impact rises from 15% in 1981 to 22% in 2020. The reason for this is that provincial government receipts and hence expenditures are a high and, over time, rising

Table 3.17: Summary of the Uranium Industry's Impact, Selected Years

Year	(1) Direct and Indirect Industry Impact		(2) Indirect Impact of Additional Government Spending		(3) Total Impact	
	Contribution to GDPP (millions 1980$)	Contribution to Employment (jobs)	Contribution to GDPP (millions 1980$)	Contribution to Employment (jobs)	Contribution to GDPP (millions 1980$)	Contributio to Employme (jobs)
1981	333	4,529	61	4,099	394	8,628
1990	686	6,305	156	10,497	842	16,802
	1,033	8,047	249	16,709	1,282	24,756
	1,493	8,156	416	27,828	1,909	35,984
2010	1,724	8,953	485	32,492	2,209	41,445
2020	1,812	9,253	512	34,284	2,324	43,537

(Source: Tables 3.9, 3.14, and 3.16)

proportion of industry value added. Table 3.18 reports the figures entered in Table 3.17 as percentages of current provicial values for comparison purposes:

Table 3.18: **Industry and Government Expenditure Impacts Expressed as Percentages of 1980 Product and Employment Levels**

Year	Contribution to GDPP as % of 1980 GDPP			Contribution to Employment as % of Total Non-Agricultural Employment 1980		
	Industry	Gov't	Total	Industry	Gov't	Total
1981	2.54	.46	3.00	1.7	1.54	3.24
1990	5.24	1.19	6.43	2.3	3.83	6.83
2000	7.90	1.90	9.80	2.9	6.02	8.92
2001	11.41	3.18	14.59	3.0	10.24	13.24
2010	13.20	3.71	16.91	3.3	11.98	15.28
2020	13.87	3.92	17.79	3.4	12.60	16.00

(Sources: Tables 3.10 and 3.17)

It will be evident that provincial government policy plays an important part in determining the overall impact of the industry on GDPP. The extent of this impact can be seen from Table 3.19: column (1) reports the direct government spending out of tax revenues from the industry; column (2) reports the indirect impact of government spending; and column (3) reports the sum of the direct and indirect impacts. It can be seen from column (3) that between 29% and 41% of total industry impact on GDPP results from government tax and expenditure policies. In other words, as compared with a situation in which provincial taxation was limited to collecting taxes and passing them on in the form and amounts of the tax reductions reported in column (1) of Table 3.12, and assuming that the federal taxes and the operator margins implied by this policy contributed to no spending within the province, the industry impact on GDPP is up to 41% higher as a result of provincial government policy. Assuming that the present tax

Table 3.19 The Direct and Indirect Impacts of Government Expenditures on GDPP

Year	(1) Direct Impact		(2) Indirect Impact		(3) Total Gov't Impact	
	Millions 1980 $	% of Total Impact	Millions 1980 $	% of Total Impact	Millions 1980 $	% of Total Impact
1981	61.5	16	52	13	113.5	29
1990	156.5	19	134	16	290.5	35
2000	249.0	19	214	17	463.0	36
2001	416.5	22	357	19	773.5	41
2010	487.0	22	417	19	904.0	41
2020	513.5	22	440	19	953.5	41

(Sources: Table 3.12 columns 2 and 3; Table 3.14 columns 2 and 3; Table 3.17 column 3.)

structure is maintained the provincial government still has considerable latitude in determining how large should be the uranium industry's impact on GDPP. At one extreme it would be technically possible to sterlize provincial tax receipts by investing them, and the interest earned on them, abroad. The impact of the industry over the forecast period would then be limited to the estimates reported in column (1) of Table 3.17. The impacts reported in column (2) of the Table 3.17 would occur at some future time at which the capital and interest invested abroad were repatriated and spent in roughly the manner described in the paper. At the other extreme it would be possible to achieve indirect impacts of government expenditure in excess of those reported in columns (2) of Table 3.17 by increasing the proportion of provincial receipts used to finance increases in government expenditure. This is the use of funds which has the highest multiplier effect on the provincial economy.

Finally, this section on the impact of the uranium industry on the economy of Saskatchewan can be concluded by a review of the assumptions underlying the estimates summarized in Table 3.17. There are four critical sets of assumptions, three of which almost certainly impart an upward bias to the impact estimates. These sets of assumptions are those about quantities of uranium produced; those about uranium prices; those about the disposition of government revenues; and those underlying the multiplier estimates used to calculate the indirect effects of government expenditure.

The quantity and price assumptions are possibly optimistic. From the world uranium demand forecasts reported on page 3.16 it can be seen that world demand, and hence, by assumption, Saskatchewan's production, may on the basis of the low OECD estimates, be 43% and 16% respectively of the estimates used in this study for the years 2000 and 2020. This would mean, for example, that, other things remaining equal, the actual impact in the year 2000 would be slightly less than the one reported for 1990. The $70 per kg. U price is probably a reasonable estimate but the forecasted jump from $70 to $100 per kg U in real 1980 dollars around 2001 is highly speculative. As was noted earlier provincial government receipts and expenditures are sensitive to uranium price and it is possible that the additional impacts on GDPP, consequent upon this increase in price, which were reported for the years 2001-2020 may not take place.

The estimates of the disposition of government revenues from the uranium industry were not intended as a forecast of provincial policy. They are based partly on recent policy towards nonrenewable resource revenues in Saskatchewan and Alberta and partly on arbitrary assumptions. It was noted that the impact multipliers for computing the indirect effects on GDPP of the disposition of government revenues range from unity in the sterlization case to 2.03 in the case of general government expenditure. Given this range of multipliers it is obvious that the estimate of the indirect impact resulting from the use of provincial revenues is sensitive to the assumptions made about the disposition of those revenues.

The multipliers used to estimate the indirect impact of government expenditures and tax reductions are based on a model of the provincial economy which makes no allowance for imports. The import leakages from the provincial income flow are likely to be significant and their inclusion in the model of the provincial economy could have a substantial effect on the values of the various multipliers. A simple example will illustrate this point: if an import leakage of 20% is added to a standard Keynsian closed model with a multiplier of 2.03, as was used for general provincial government expenditures, the value of the multiplier falls to 1.44. Changes of this magnitude would make a significant difference to the estimates of the indirect impact of government expenditures and tax cuts reported in Table 3.14.

When the provincial economy is stimulated by the tax cuts and additional government expenditure it is implicitly assumed in the multiplier calculations that additional factors of production are available to the economy at current factor prices. The magnitude of the impacts of these fiscal measures suggests that sufficient additional factor supplies could not be obtained from pools of unemployed resources in Saskatchewan. The implicit assumption, therefore, is that factors will migrate from other regions even although factor prices remain unchanged. As was apparent in the review of booming sector models in Part 1 of this study it is unrealistic to assume in-migration of labour in the absence of a wage increase. The increase in wages which will be necessary to attract labour to the government and nontraded goods sectors from other sectors of the economy and from other regions will raise the unit cost of production. This means that the estimates of Table 3.14 are overestimates of the real impacts of government policy on provincial GDPP.

Section 3

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Department of Energy
Washington, D.C. 20461

July 24, 1981

Dear Requester:

The Department of Energy has transmitted to Senator Peter Domenici a report entitled "The Domestic Uranium Industry and Imports of Uranium," which was prepared at the Senator's request. A copy of the report is enclosed as per your request.

Sincerely,

John A. Pattersen, Program Manager
Resource Assessment
Office of Uranium Enrichment
and Assessment
Nuclear Energy

Enclosure

THE DOMESTIC URANIUM INDUSTRY AND
IMPORTS OF URANIUM

FEBRUARY 23, 1981

Division of Resource Assessment Operations
Office of Uranium Resources and Enrichment

U.S. DEPARTMENT OF ENERGY

(Patterson Report)

Foreign Development and Export Policies

Government policy toward uranium exploration production and exportation varies significantly among the major uranium exporting nations. In the case of Canada it varies among provinces. Generally, foreign governments treat uranium as a nuclear material needing central control much more than other mineral commodities. As Australia and Canada are the principal potential sources of additional foreign uranium that might be imported, their development and export policies are highlighted below.

Australia

- Sales are permitted only to countries with bilateral agreements for peaceful uses who have signed the Non-Proliferation Treaty. Sales are subject to IAEA safeguards inspection and consent is needed for reprocessing or transfer.
- Prior consent would be required for buyers - including U.S. buyers - to process Australian uranium.
- Sales policy and contract guidelines are provided to producers.
- New contracts are subject to government approval, including duration of the contract, quantities involved, method of shipment, price, and use of the uranium.
- Sales prices are based on prevailing market prices, but have negotiated floor prices that are subject to escalation for cost increases and market price developments.
- Contracts provide for a portion, up to 35 percent, of uranium sold to be in the form of converted uranuim (UF_6), or enriched uranium, starting in 1990.
- Regulated development of resources by private enterprise with foreign exploration is permitted.
- Australian control of producing uranium properties is required. A 75 percent share is desired, but participation can go as low as 50 percent in exceptional circumstances.

The Australian Labor Party, which is now the opposition party, has indicated they may disavow uranium sales contracts, if they are voted into power. However, uranium policy has been the subject of debate within the party. This has clouded the Australian position as a supplier in the views of some, though their ability to disavow contracts will diminish as time goes on and the industry becomes more established. Some labor unions have also opposed and impeded uranium activities.

Canada

- All exports must be for peaceful purposes only, and appropriate nuclear safeguards arrangements and bilateral agreements must be in place.

- All aspects of exports sales are subject to review and approval by the Government.

- Export approvals will be limited to 15 years from date of contract signing, the last five of which may be subject to partial control.

- Domestic utilities are expected to maintain a contracted 15-year forward fuel supply for their operating and committed reactors. A producer's uncommitted uranium resources must be sufficient to meet its share of the 30-year national requirement.

- All exports of uranium must be processed to the most advanced form possible in Canada, unless special exemption is obtained. Currently exports are in the form of UF_6.

- Pricing conditions offered to foreign customers will not be more favorable than those offered domestic purchasers. Final prices must reflect prevailing world prices and are subject to annual renegotiation. Contracts must contain floor prices covering production costs.

  ← not followed

- The Federal Government's uranium stockpile will be disposed of only on the domestic market and will be available on a loan basis for the needs of Canadian producers and utilities.

  ← abrogated

- Non-resident ownership of new uranium operations will be restricted to 33 percent. Exceptions may be granted that would permit a maximum uranium level of 50 percent, if judged to be of significant benefit to Canada. No exceptions have been granted to date.

The Canadian provinces have been increasingly involved in development and control of the uranium industry. British Columbia and Saskatchewan have been particularly active. In February 1980, the government of British Columbia declared a seven year moritorium on uranium exploration and the development of deposits already discovered. The Saskatchewan government, on the other hand, has been very actively participating in the uranium industry. It established a government corporation, the Saskatchewan Mining Development Corporation (SMDC), in the early 1970's to participate in exploration, development, production, and sales of uranium in the province. SMDC has the right to participate in any private exploration project it chooses and acquire up to 50 percent equity. The corporation has been very aggressive and now constitutes a major force in the Canadian uranium industry.

Saskatchewan also has a provincial royalty system related to the profitability of the operation, which can add significantly to costs. Provincial royalties can be over $15 per pound of U_3O_8 produced.

Cartels

The concentration of world uranium resources and production has, in past periods of low prices and ore production, fostered attempts to form cartel-like organizations seeking to restrict the free movement of uranium and influence pricing. The concentration of uranium production in a few countries will continue for some time, though there is an increasing diversity of supply sources. The opportunity for future foreign cartel-like activities will continue, particularly if uranium producer country governments are involved, which has been the case in the past. However, the severe criticism of such practice and the legal actions that have resulted in the United States might operate to discourage such activities in the future. Since the U.S. has the capability of producing a large portion - or all - of its uranium needs and U.S. uranium buyers historically have shown a strong preference for domestic uranium, the U.S. is not expected to develop a large dependence on foreign uranium. These factors would tend to reduce the susceptibility of the U.S. to direct impacts of any cartel-like activity.

CONTROLLING THE USE OF URANIUM IN THE UNITED STATES

Experience To Date

Our experience regarding use of foreign uranium was summarized in Figure 23. As indicated in Figure 23, in 1977 some 703 tons U_3O_8, or about 4.7 percent of the uranium brought to the Government's enrichment plants for domestic end-use, was of foreign origin compared to an allowable 10 percent. In 1978 some 728 tons, or about 5.7 percent foreign uranium, was brought to the plant compared to an allowable 15 percent. In 1979 the quantity increased to 1,391 tons, about 9.3 percent of the feed, compared to the allowable 20 percent. In 1979 toll enrichment feed deliveries involved 46 domestic utilities and reactor manufacturers. Nineteen of these companies, or 41 percent, utilized some foreign uranium. Eight of the companies used 19 percent, or more, of feed of foreign origin or, in effect, virtually all that was allowed to them. Some 44 percent of the uranium was of Canadian origin, 10 percent from Australia, 19 percent from South Africa, and the balance from France and its African uranium partners.

Deliveries in 1980 were at a higher level than 1979. Some 1,241 tons, or 10 percent of the uranium provided, was of foreign origin compared to an allowable 30 percent. Sixteen of 46 companies bringing uranium to the enrichment plant utilized foreign fuel. The 16 used an average of 23 percent foreign feed. Eight used the fully allowable 30 percent.

In summary, experience to date has been that actual use of foreign uranium has been well below the allowable quantities. Uranium buyers have preferred domestic origin material and most utilities have used no foreign uranium at all. To date, the current plan for removal of restrictions has worked out well.

Outlook Under the Current System

It is likely that over the next few years most domestic utilities will continue to buy U.S.-origin uranium and that the actual percentages of foreign uranium utilized will be well below the allowable quantities.

The percentages allowable, however, in 1981 and later years will be sufficiently high that they would allow the use of a fairly large percentage of foreign uranium. To overcome current buyer preference for domestic uranium would likely require some combination of significant price differential for foreign uranium and assurance of supply from foreign sources under such purchase contracts. The pricing of foreign-origin uranium has not been significantly different from U.S. prices, as foreign producers and governments have been seeking the highest prices attainable. Current policies suggest a continuing desire not to disrupt world prices or to instigate a price cutting activity to gain market dominance. The possibility for price cutting, however, does exist.

Experience suggests that there will be uncertainty about assurance of foreign supplies. Unilateral cutoffs of shipments, or changes to contract terms and prices, have been made from time to time and are possible with any change in government. The increasing role of state or provincial governments to extend controls over uranium production also creates questions of supply assurance under contracts. Buyers can, of course, reduce such risks by a mixture of foreign and domestic procurement and by diversifying foreign procurement amongst several suppliers.

A plausible course of events under the current schedule for removal of restrictions would be the increasing use of foreign uranium and the development of a price differential between domestic and foreign sales. The magnitude of the price differential would be very influential in determining the extent of utilization of foreign uranium. However, as additional market opportunities in the U.S. are limited over the next 5 years, the further penetration of foreign-origin uranium will be restricted in that time period.

The outlook may be clarified by reference to Figure 32. Projected requirements for the 1981 through 1985 period are some 98,700 tons U_3O_8, for which some 84,000 tons are under contract with domestic producers and 12,900 tons with foreign producers. (In addition, the buyers hold some 36,000 tons in inventories). The foreign deliveries constitute about 13 percent of the requirements and about 13 percent of total purchase commitments. The contracted deliveries show that very little additional uranium procurement is needed through 1985.

Nonetheless, there are some utilities that do need additional uranium. If their unfilled requirements are considered, the picture may change. The estimates of unfilled requirements were reported to DOE in early 1980, and hence are likely to have been reduced by this time. If all the reported unfilled requirements were filled with foreign uranium - a worst possible case - the percentage of procurement from foreign sources for the 1981 through 1985 period, as shown in Figure 32, would increase from 13 percent to 23 percent. Annual values would range from 13 percent in 1980 to 33 percent in 1985.

In the period after 1985 the foreign uranium under contract is a lower percentage of requirements, around 4 percent through 1990. Inasmuch as unfilled requirements were higher post-1985, the maximum possible foreign uranium is also higher. The maximum increases to 47 percent in

April 11, 1985

Presentation on
Canadian Uranium Policies

Senator, your question is broad and my time is limited so I will focus solely on Canada, which is the principal source of uranium imported into the United States. Most of my information in this area was developed while working on behalf of domestic uranium companies. However, I am not speaking here on behalf of any private interest nor am I a representative of the Canadian government. My statement below is based on published documents -- chiefly from Canada or the U.S. government. I will supply copies of them to you, and anyone interested in checking my information or pursuing this further can then obtain them from your office.

* * *

One fact that is clear is that the government of Canada does not follow a "laisses-faire" or non-interference policy with respect to its uranium supply industry. To the contrary, Canada is heavily involved in its uranium industry -- some of the principal producers are owned either by the Canadian government -- such as Eldorado -- or by the Province of Saskatchewan -- such as Saskatchewan Mining Development

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

September 27, 1984

TO : Honorable Jeff Bingaman
Attention: Mitch Foushee

FROM : John Ellis JE
Research Assistant
Congressional Research Service

SUBJECT: U.S. and Canadian Uranium Prices

Extensive uranium price data for the U.S. are published annually in the Department of Energy's "Survey of United States Uranium Market Activity" (call Julia Oliver, DOE, at 252-1676 for copies). Because there are only three Canadian nuclear utilities, however, data on uranium purchase prices in Canada are not made available to the public. Nonetheless, because of the much larger number of export transactions, government officials were able to provide CRS with average annual Canadian export prices (call Mr. Hank Merlin, Canadian Department of Energy, Ottawa, at 613/995-7474).

In table 1, average uranium purchase prices for Ontario Hydro, which supplies over 90 percent of current Canadian nuclear energy output, are presented. These statistics were published recently in the trade journal, Nuclear Fuel (June 18, 1984, p. 4). Since Ontario Hydro appears to maintain a special relationship with high cost Ontario uranium producers (discussed in more detail below), however, these prices may be significantly higher than the Canadian national average. The striking contrast between current spot prices and Ontario Hydro's contract purchase prices, mentioned in the September 12, hearings before the Senate Energy Research and Development subcommittee, is of course one of the concerns that prompted your inquiry of CRS.

TABLE 1. Average Contract Prices For Ontario Hydro (Canada), All Canadian Exports, All U.S. Nuclear Utilities and All U.S. Imports of Uranium (in current U.S. dollars)

		Ontario Hydro	Canadian Exports	All U.S. Utilities	All U.S. Imports
Actual --	1982:	29.79	35.50	38.37	25.19
	1983:	37.79	30.40	37.81	26.16
Projected --	1984:	59.65	—	46.42	—
	1985:	65.00	—	49.21	—

Sources: U.S. Department of Energy. Survey of United States Uranium Marketing Activity. 1982 and 1983.
CRS Inquiry of Canadian Federal Department of Energy, Ottawa. September 20, 1984.

In his testimony presented at the September 12 hearings, Donald Rausch of Western Nuclear, Inc. also drew attention to the extremely unfavorable comparison between current spot market prices and historical average U.S. purchase prices under long term agreements. This differential is indeed of much concern to producers for the future, when average purchase prices will be affected by contract agreements that are now being signed under the downward influence of depressed spot market prices. Average purchase prices being paid under existing long term contracts, however, are more germane to the U.S. uranium industry's poor performance now and in the recent past.

In 1982, average Canadian export prices exceeded the average uranium price paid by Ontario Hydro under its long term contracts. This would indicate that the average cost of Canadian fuel to U.S. nuclear utilities may have exceeded the average cost of Canadian fuel to Canadian utilities in that year. This would appear to be inconsistent with the large quantity of Canadian exports to the U.S. in 1982. But, as is noted in the footnote to table 2, a one-time transfer of 7.2 million pounds of U3O8 from a Canadian to a U.S. company accounted for 74 percent of that year's Canadian exports to the U.S. This obscures the fact that conventional Canadian sales to U.S. utilities actually declined by 26 percent in 1982.

In 1983, the differential between Canadian export prices and Ontario Hydro's average purchase prices was reversed. Price escalation clauses in Ontario Hydro's existing long term contracts, negotiated earlier, when market conditions were much more favorable to uranium producers, drove the utility's average purchase price up by 27 percent. At the same time, a number of new Canadian export committments were made under weakening market conditions, so that the average export price fell by 14 percent. (See table 1) Nevertheless, Canadian U3O8 export sales in the U.S. declined by an additional 48 percent in 1983 (ignoring the 7.2 million pound transfer already mentioned -- see table 2).

The market price trend from 1982 to 1983 is expected to continue throughout the remainder of the 1980s. In contrast, Ontario Hydro's average purchase price, still driven by its older long term contracts, are projected to increase by 72 percent between 1983 and 1985. Of course, U.S. utilities are similarly affected by past purchase agreements. But because they rely on shorter term supply agreements than the Canadians, contract prices agreed to under recent depressed market conditions will begin to have a significant effect on average U.S. purchase prices earlier than will be the case in Canada. The U.S. Department of Energy has estimated that average U.S. uranium purchase prices under existing contract committments will also rise between 1983 and 1985 -- but by a more modest 30 percent. Most of this increase will occur in 1984, before delivery begins under recently signed, low price contracts. In all likelihood, then, the economic environment for uranium producers will become even worse in the U.S. than in Canada.

A lag between the U.S. and Canadian contract cycles appears to be at the root of the problem for U.S. uranium producers, many of whose existing contracts have begun to expire during a period of extremely depressed market prices. Canadian utilities' continuing long term purchasing committments, on the other hand, seem to have helped to cushion their uranium suppliers from the currently harsh economic conditions.

TABLE 2. Total Uranium Imports and Uranium Imports from Canada, 1981-1983
(in million pounds of U308)

	Imports From Canada	Total U.S. Imports	Canadian Share of U.S. total
1981 :	6.6	3.4	52%
1982 :	17.1 *	9.7 *	57% *
1983 :	8.2	1.3	16%

* In 1982, 72. million pounds of U308 were transferred from Eldorado Nuclear of Canada in exchange for Gulf Oil's equity interest in Rabbit Lake uranium mines in northern Saskatchewan. Actual Canadian uranium sales in the U.S. amounted to 2.5 million pounds, 34% of purchased U.S. imports.

Sources: Department of Energy. Survey of United States Uranium Marketing Activity. 1982 and 1983.
"Canada Reports Exports for 1983 Dropped from 1981 and 1982 Levels" Nuclear Fuel. July 30, 1984, p. 9.
Thomas Neff. The International Uranium Market. Cambridge, Ballinger Publishing Co., 1984. p. 151.

This U.S.-Canada contract lag, however, has not simply been due to historical happenstance. Since 1974, the Canadian government has required all its nuclear utilities to contract forward for at least 15 years of uranium supply. This has provided Canadian uranium producers with a much more stable long term market than has been available to most U.S. firms -- an advantage that has proved to be especially beneficial in the early 1980s. In contrast, U.S. utilities have been wary of past misfortunes resulting from being locked into high price contracts and unconcerned about the adequacy of future uranium supplies, which has led them to rely more heavily on short term purchasing strategies. This is why currently low spot market prices will be reflected in average U.S. contract purchase prices sooner than will be the case in Canada.

It is also important to note that some important Canadian uranium producers enjoy a substantial advantage in term of costs of production. Whereas evidence from the recent Senate hearings indicates that average U.S. operating costs are in the $30-35 per pound range (see, for example, "Testimony on behalf of the American Mining Congress, September 12, 1984, p. 5), it has been estimated that some new mines in northern Saskatchewan can operate at a profit at prices around $20 per pound (see Thomas Neff, The International Uranium Market, Ballinger Publishing Co., 1984, p. 153). This cost advantage is due primarily to higher uranium ore grades and to economies of scale at large deposits.

Does the evidence indicate that Canadian government or industry has consciously adopted a practice or policy of "dumping" uranium supplies in the U.S. market at below their cost? Formally, and at the Federal government level at least, the answer appears to be "no". Since 1974, the Canadian Atomic Energy Control Board (AECB) has been prohibited by law from licensing uranium exports "if the pricing conditions for foreign customers are more favorable than those offered to domestic purchasers". A federal policy requiring that U308 be upgraded to uranium hexafluoride (UF6) prior to exportation reportedly caused two prospective U.S. purchasers to decide against Canadian uranium supplies in 1983 (see Neff, pp. 153, 160). Thus, despite the troubles currently being experienced by U.S. uranium producers, Canadian exports to the U.S. in 1983 were down 62 percent from 1981, falling from 52 percent to less than 16 percent of all U.S. imports in that two-year period. (See table 2)

On the other hand, some provincial policies seem to be having a clearly detrimental, albeit indirect, effect on U.S. uranium producers. Ontario Hydro, which is owned and controlled by the province of Ontario, has reportedly recently come under fire from its own Federal government for signing very expensive long term supply contracts with uranium producers in Ontario, when lower cost supplies might have been available from Saskatchewan. Ontario Hydro officials have stated that the desire to preserve employment in Ontario was a principal rationale for those actions. (Nuclear Fuel, June 18, 1984, p. 4) The result, however, has been that low costs Saskatchewan producers, faced with this restraint on their market prospects in Canada, may have a greater portion of their output seeking foreign markets, including the U.S., than might otherwise have been the case. In July 1984, it was reported that the Virginia Electric Power Company (Vepco) purchased 500,000 pounds of U308 from the Saskatchewan Development Mining Company (SDMC) at the very low prevailing spot price of $18 per pound. (Nuclear Fuel, July 2, 1984, p. 2)

Finally, as was detailed in testimony presented by the American Mining Congress at the September 12 Senate hearings (pp. 22-23), Canadian government does provide extensive financial assistance to both private and public sector Canadian uranium producing companies. The actual cost advantages that might result from thse transactions is difficult to determine and beyond the scope of this memorandum. As an example, however, one would have to calculate the difference between the rate of return on government investment and the rate of return on equity held in the private sector to determine the level of subsidy resulting from Eldorado Nuclear's exchange of stockpiled uranium for Gulf Oil's interest in the Rabbit Lake uranium deposits or from the province of Saskatchewan's equity advance of $250 million to SMDC.

I hope that this memorandum will shed some light on this extremely complex issue. If you have any additional questions, please feel free to telephone me at 287-7245.

THE POLICY ENVIRONMENT FOR
SASKATCHEWAN
URANIUM PRODUCERS

Atomic Industrial Forum Uranium Seminar
Keystone Conference Centre

September 30 - October 3, 1984

A Paper Presented by Bob Reid,
Deputy Minister, Saskatchewan
Energy and Mines

Key Lake, the western worlds largest uranium mine, with an annual output-capacity of 12 million pounds of uranium oxide per year, came on stream late last year and has made Saskatchewan Canada's leading uranium producer.

Although Key Lake and the other producers from the Athabasca basin region - Cluff Lake and Rabbit Lake - have given Saskatchewan an international profile in the world of uranium, the province has been a uranium producer since 1953 when lower grade vein deposits in the Beaverlodge area were brought into production.

In these early years uranium was classified as a strategic mineral and was subject to strict federal controls. As a result provincial involvement was minimal, being generally restricted to the issuance of mineral rights for Crown lands. With the advent of nuclear power in the seventies uranium gained prominence as a fuel mineral and the provinces generally and Saskatchewan in particular started to take a more active part in the monitoring and regulation of their uranium industries.

In Saskatchewan at this time there was a growing realization in government circles that the massive orebodies of the Athabasca Basin represented a unique opportunity as far as the uranium industry was concerned and the government of the day - introduced an entirely new uranium policy - a significant change from the previous hands off approach. The main aspects of this policy were as follows:

1. to optimize the rate of return to the province from royalties and taxes by the introduction of the Saskatchewan uranium royalty, a graduated profits tax
2. to introduce a high degree of direct public sector involvement by the creation of a provincial Crown corporation, Saskatchewan Mining Development Corporation (SMDC) and the introduction of a compulsory joint venture program which required every claimholder to offer SMDC an opportunity to earn up to a 50% interest in their property.
3. to maximize the socio-economic benefits of any such development for northern residents by imposing special requirements on recruiting and contracting through the terms of a surface lease.
4. to ensure that the health and safety of both the workers and the general public were safeguarded.
5. to minimize interference with or pollution of the bio-physical environment.

The procedure for bringing a uranium property into production evolved into a number of distinct steps reflective of these policy developments:

1. - exploration rights for an area are obtained by staking claims or applying for a permit, no special license is required to do this.

- these are renewed annually provided work commitments are met as laid out in the Mineral Disposition Regulations, 1961.

2. - promising areas of mineralization are converted to mineral leases to secure the right to extract minerals from that property subject to existing mining regulations.
3. - once a production decision has been reached an environmental impact assessment report must be submitted before any further work can proceed.
   - this document outlines all aspects of the proposed operation and indicates the measures planned to minimize the disruption of the bio-physical environment.
   - these reports are available for public review and in some instances a public board of inquiry may be recommended.
   - this process is administered by Saskatchewan Environment.
4. - once environmental approval is obtained the property owner must then obtain surface rights before any construction work can proceed.
   - the surface lease is a legal document and is the main instrument whereby the Saskatchewan government can insure that the project developer meets certain prescribed objectives.
   - these include compliance with provincial standards for both environmental protection and occupational health and safety and the securing of socio-economic benefits for northern residents.

- this process is administered by Saskatchewan Parks and Renewable Resources.

5. - construction and the subsequent production require a variety of certificates and licenses from Saskatchewan Environment and AECB.

The present provincial government - the Progressive Conservatives - was elected in 1982 and inherited this uranium policy and a substantial investment of tax payers money in uranium mining. Their view of the industry can be illustrated in remarks by the Minister of Energy and Mines, the Honourable Paul Schoenhals who at a Uranium Institute meeting in Saskatoon in June of this year stated that: "abundant high grade reserves are of little value if a suitable political climate doesn't exist, as evidenced by the cancellation of production decisions in other Canadian jurisdictions due to policy and legislative changes. I am of the view that uranium mining can take place in a manner that protects the environment and provides employment and economic benefits. We realize that the mining industry is a significant contributor to the provincial economy both in terms of direct revenue generation and in the creation of direct and indirect employment opportunities".

While the present government is committed to the orderly development of this industry, they also want to ensure that suitable social and economic benefits are provided for Saskatchewan residents in general and northern residents in particular. To achieve these objectives the government sees producers adopting measures such as:

- establishing special training programs for northerns so that they can take advantage of employment opportunities generated by this new development.
- striving to exceed government set occupational health and safety standards to ensure a safe working environment for their employees.
- monitoring the impacts of the operation on any indigenous population to ensure that it is not creating any health hazards.
- supporting research on the effects of exposure to low levels of ionizing radiation.
- devising procedures to help further minimize the impact of the operation on the bio-physical environment.

It is clear that the previous government was strongly committed to direct equity participation in the industry. The present government, while still seeing some role for public sector involvement, wants to promote increased private sector involvement. To this end the compulsary Crown Equity Participation requirement was repealed. Also SMDC's mandate was revised to make it operate more like its competitors in the private sector.

In terms of general policy direction the government's role will become more that of a custodian of the province's mineral resources and a regulator of development activity rather than a leading participant in resource development. Ongoing exploration activity in the uranium sector indicates a continuing long term development commitment on behalf of industry. The government is aware of the high level of risk capital involved in mineral exploration and development and would like to assure industry of a commitment to support uranium development as long as it continues to be performed in an orderly and responsible manner.

It is too early to say whether any further major changes will be made in the area of policy and legislation as we are still in the process of monitoring the health of the industry under the existing regime. However, in the event that further changes are required they will be handled consistent with the approach taken to date. The government is well aware of the importance of the private sector in promoting development and growth within the industry. Therefore, it is the policy of the Saskatchewan government to consult with industry representatives before making any major legislative or policy changes so that we can work in a spirit of co-operation and mutual trust in order to maintain an optimal investment climate in this province. One recent example of our government's concern for change is the uranium mining regulations prepared by our environment department. These were developed as a result of extensive consultations with industry.

From a provincial perspective uranium is unique among hard-rock minerals in that much of the legislation regarding mining, processing and marketing falls under Federal jurisdiction.

The Atomic Energy Control Act gives the federal government jurisdiction over Canada's uranium industry, although mineral resources are generally under provincial jurisdiction. The Atomic Energy Control Board (AECB) administers the Act by means of a licensing system prescribed in its regulations. The AECB was established initially to deal with health, safety, security and environmental concerns as well as with commercial matters, such as exploration production and export. In November, 1977, the Federal government tabled a Nuclear Control and Administration Act (Bill C-14) in the House of Commons with the objective of separating the AECB's responsibilities for health, safety, security and the environment from commercial and promotional matters. The provinces took strong exception to many aspects of Bill C-14 and the Bill was never passed. In fact two subsequent measures reduced the AECB's role in regulating commercial matters. First in August 1979, the AECB ceased to license surface uranium exploration activities, then in October 1979 the chairmanship of the Uranium Exports Review Panel was moved from the President of the AECB to the Assistant Deputy Minister, Energy Policy in Energy, Mines and Resources (EMR). Consequently EMR became responsible for monitoring Canada's uranium policy and for formulating changes to the policy as required.

While these were steps in the right direction Saskatchewan feels that the provinces should have direct control over occupational health and safety, all environmentally related concerns and exploration, development, and production. The concept of uranium as a strategic mineral no longer applies and consequently the provinces should have the same control over uranium that they have over their other mineral resources - as owners of the resources. Also provincial standards tend to be stricter than those imposed by the federal government and the duplication in complying to both sets of regulations places an unnecessary burden on the industry. On the other hand issues as security of domestic supply, export controls and non-proliferation are best left under control of the federal government.

The primary objective of Canada's uranium policy is to ensure the continuity of Canada's role as a reliable long-term supplier of uranium. In developing these policies the federal government has attempted to maintain a national objective by encouraging the development of all resources - those which are higher cost as well as those which are low-cost.

In developing the commercial aspects of Canada's uranium policy the Federal government has always recognized that periodic reviews and modifications would be required to respond to changing supply and demand conditions for uranium. A major policy review was undertaken in 1974 which focused on the security of uranium supply for the domestic nuclear program. In view of the conditions which have changed since then the Canadian government completed a review of existing policy in 1983. This recent review concentrated on four elements of the policy:

1. security of supply,
2. further processing,
3. the contract review process,
4. foreign ownership in the uranium mining industry.

The long term security of supply for the domestic nuclear program is not as pressing an issue as it was in 1974. At that time Canada's nuclear power program was projected to expand to over 100 Gigawatts electric by the turn of the century when annual demand was expected to be 11,000 tonnes U. It appeared that excessive export commitments could potentially hamper Canada's nuclear power program. Consequently a policy was developed which required individual producers and utilities to contribute to security of supply by setting aside or partially contracting for sufficient uranium to fuel operating and committed reactors for 30 years. Approval of an export contract was limited to 10 years, with an option for five additional years subject to a right of recall by domestic utilities. Since then the situation has changed dramatically. More uranium has been discovered, much of it in

Saskatchewan, domestic utilities have contracted their needs for 30 years on average and domestic demand by the end of the century is expected to be less than 3,000 tonnes U annually. There seems little likelihood, therefore, that either short or long-term domestic or export security of supply will be threatened by depletion of Canada's uranium resource base.

The Canadian government has decided, therefore, that security of supply for the Canadian nuclear program will be monitored by examining available supply and contracted commitments on a national basis, rather than examining the situation for each individual producer or utility. Henceforward, the Ministers also agreed that export contracts could be approved for a period not exceeding fifteen years from the date of execution of the contract without the domestic recall provision. With respect to uranium contracts associated with the sale of CANDUs and where benefit to Canada from such CANDU sales is significant, approval of such contracts can be given to cover the uranium supply for up to thirty years for such CANDUs.

This policy change was well received by Saskatchewan as it gives the individual producers more freedom, in soliciting export contracts and hence helps improve the overall investment climate.

In 1973 the ministers responsible for mineral policy in the federal and provincial governments agreed on a number of general policy objectives including the realization of opportunities for further mineral processing in Canada. Consequently in 1974 the Canadian government indicated that uranium should be exported from Canada in the most advanced form, namely UF_6, unless special exemptions were granted. The policy provides for the regulating agencies to consider requests for exemptions from the further processing provision if the Canadian facilities do not have the capacity or if they are not generally competitive in the world scene. Exemptions for other reasons would only be granted in the most exceptional circumstances. The further processing policy is a long-standing one and applies to many other resources. The Canadian government reaffirmed this objective in their recent review. Export of uranium as concentrates will require special review and exemption by the Ministers. Such exemption will only be given in highly exceptional circumstances.

The reaffirmation of this policy objective has been a matter of concern for some of Saskatchewan's uranium producers as the stringent application of this policy is causing the loss of sales contracts. Some potential contracts have fallen through due to the rigid pursuit of the conversion requirement while others have had to offer price concessions to offset the cost of the conversion requirement. Also it is reported that some purchasers will not

even talk seriously with Canadian producers because they do not believe that it is possible to conclude an economically justifiable transaction if they must purchase converted uranium. While we are supportive of the objective of processing mineral products to the greatest extent feasible before they are exported from Canada, no benefit is obtained when sales contracts are lost to our country's competitors. Considering many of the utilities are saddled with take-or-pay conversion contracts and the value added by conversion is relatively small the provincial position is that rigid pursuit of this policy would be more appropriately left until uranium markets firm up again. Provincial ministers recently met with their federal counterparts and urged them to adopt a more pragmatic approach to this issue.

Canada's uranium export policy was designed to enhance market stability while at the same time ensuring the viability of Canadian uranium production centres. In 1969 the uranium export contract review process was initiated to ensure that the contracts would not be harmful to any of the producers, to ensure the greatest possible monetary benefit to Canada, and to see they contribute to the orderly development of uranium markets. A rapid increase in production costs in the latter half of the seventies prompted the Canadian government to develop a policy advocating pricing mechanisms to protect the investment and employment in production facilities. The policy, requiring contracts for export of uranium from Canada to have provision for an escalating floor price and annual price renegotiation, was announced in a letter from the Minister of Energy and Mines to Canadian uranium producers dated March 17, 1977. Uranium deliveries were to be made at the higher of the floor price or a price negotiated annally based on the prevailing world market price. Consideration would be given to such factors as term and size of contracts and any special financial arrangements. In the recent policy review the Ministers have decided that escalating floors, or similar mechanisms, are still required in export contracts to protect investment and employment in Canadian uranium production facilities because a dramatic drop in uranium prices could cause uranium production centres to lose their economic viability in the short term.

The review of contracts, initiated in 1969, will continue to be required prior to application to the regulatory authorities for export permits and licenses. The review will continue to ensure that contracts are in the national interest. The terms of sale should equitably balance benefits and risks and should generally be in accord with those being obtained by Canadian and international producers for uranium under contracts of similar duration. The review will continue to take into account the implications of such matters as international non-proliferation, the relationship between contracting parties, price and volume of sales to the export market, and reserves and rate of exploitation.

The contract review will be performed by the Uranium Exports Review Panel, which includes representatives of the departments and agencies responsible for issuing export permits and licenses. The review will assess contracts to ensure consistency with the policy principles enunciated above. The Panel will make every effort to ensure that the contract review is as expeditious as possible.

Producers will still be expected to submit their contracts for domestic sales of uranium to the Uranium Exports Review Panel for information purposes, and to ensure that a Canadian uranium producer is not offering pricing conditions to foreign customers which are more favourable than those offered by the producer in the same time period to domestic purchasers.

The provinces have no major concerns with the contract review process other than it be completed as expeditiously as possible.

The control of foreign investment in what have been considered to be key sectors of the Canadian economy has been taking place since the mid-fifties through a variety of legislated mechanisms. However with the passage of the Foreign Investment Review Act in December 1973, the federal government assumed a major role in controlling foreign investment in Canada. A policy was set limiting foreign ownership in the uranium industry to 33 1/3% non-resident ownership except in cases where the property is

Canadian-controlled or where development of the property is determined to be of significant benefit to Canada. In such cases, non-residents can own up to 50 per cent of the property. This policy was to be formally incorporated in the Uranium and Thorium Mining Review Bill (C-64) table in June 1978, however the bill was never passed.

In the latest round of policy review the federal government decided to increase the options for non-residents in meeting the ownership requirements and they extended the date for meeting requirements to up to three years after the commencement of production if:

1. the partners in a joint-venture in which non-resident participation exceeds 50 per cent continue to seek, and report regularly to officials of the Department of Energy, Mines and Resources on efforts to find, sufficient Canadian equity participation to meet the policy requirements prior to commencement of production;
2. the partners in the joint-venture negotiate with the Canadian government a mutually agreeable and definitive agreement specifying actions to ensure that the mining project meets the Canadian ownership criteria within three years after commencement of production;
3. a determination is made by the Canadian government that the proposed project, if not Canadian-controlled, will be of significant benefit to Canada.

Saskatchewan recognizes the importance of foreign capital in developing our resource base and hence views rigid application of the Foreign Investment Review Act as a deterrant to resource development in the province. Considering the large amounts of "high-risk" capital required for mining projects and the relative scarcity of such funding in Canada strict control of foreign investment can limit the growth of Canada's mining industry.

There are no provincial restrictions on foreign capital investment as it is believed there are other ways of ensuring "significant benefit to Canada".

The federal government has indicated that they will continue to review their policies to ensure that Canada maintains a healthy national uranium industry responsive to the needs of both export and domestic customers so that Canada remains a secure supplier of uranium over the long term.

The outlook for Saskatchewan's uranium industry is generally optimistic. Although current growth is much slower than what was predicted a few years ago, development is proceeding at a steady pace. Nuclear power will be needed and I can foresee many countries around the world coming to rely on Saskatchewan as a secure and dependable source of uranium.

The high grade and massive nature of Saskatchewan's Athabasca basin uranium deposits makes them particularly competitive in times of soft market conditions. Saskatchewan has the productive capacity and the technical expertise for new mine development to make major inroads as market conditions improve. Therefore I am confident that uranium mining will be a growth industry over the longer term and that it will continue to be a significant contibutor to the provincial economy for many decades.

Chairman's Message

On behalf of the Board of Directors, I hereby present the annual report of Eldorado and its wholly-owned subsidiaries for the year ended December 31, 1983.

During 1983, the performance of all divisions was highly commendable. Although some problems were encountered during the transition from construction to commissioning of new facilities, all production cost objectives were achieved. Moreover, an aggressive marketing program enabled Eldorado to sell nearly all of its record mine production and to maintain its market share for refining and conversion, despite unfavourable market conditions.

As a result, I am pleased to report revenues of $154 million for the year ended December 31, 1983, up from $88.8 million the previous year, and net earnings of $10 million compared with $3.6 million in 1982.

Eldorado has now completed a decade of planned expansion aimed at making the company a world-scale supplier of uranium mine concentrates and conversion services. Total assets have increased eight-fold as a result and now amount to approximately $915 million. The 1981 acquisition of the Government of Canada's uranium stockpile has played a significant role in creating the new asset base. Most of this uranium inventory was used in October 1982 to purchase the valuable Rabbit Lake properties, a uranium mine and mill together with sizeable undeveloped reserves. The Rabbit Lake operation has been one of Canada's major uranium producers since it went into production in 1975.

In 1983, the company:

— Participated in the development of the Key Lake uranium property in northern Saskatchewan, which was brought into production in the fourth quarter;

— Began developing the new Collins Bay uranium deposit, also in northern Saskatchewan, and making the necessary modifications to the nearby mill at Rabbit Lake;

— Completed construction of a new uranium refinery at Blind River, Ontario, and the new uranium hexafluoride conversion plant at Port Hope, Ontario within budget.

— Negotiated the acquisition from Aberford Resources Limited of its minority interest in the net profits generated by the Rabbit Lake operations; and

— Conducted a preliminary assessment of opportunities for the company's Shareholder, the Canada Development Investment Corporation, to return Eldorado to the private sector.

Eldorado has committed approximately $550 million to new mine development in northern Saskatchewan and new uranium processing capability in Ontario. The company now owns significant uranium resources and a new generation of production facilities, and thus no longer faces capacity limitations that formerly constrained supply to utility customers.

During the next few years, the main constraint will be selling the company's products and services in an oversupplied world market. By 1990, however, the electric utility industry in North America will have doubled its nuclear generating capacity as reactors ordered in the mid-1970s come into service. In addition, European and Japanese utilities are expanding and are expected to increase their demand for uranium substantially. We are confident that Eldorado's experience, stretching back to uranium's beginnings as a fuel, combined with the company's extensive dealings with utilities, will assist in obtaining an increased market share over the long term.

While Eldorado will continue to be a major participant in the growing demand for uranium fuel, a repetition of last year's growth in revenue and earnings is not expected in 1984 because of market conditions and financing costs.

Markets for both uranium and conversion services were affected in 1983 when some foreign utilities sold their excess inventories below costs. The uranium hexafluoride market, in particular, was disrupted by converted uranium being sold at or close to prices for unconverted uranium. This secondary market reduced the opportunities for new conversion business, and this situation is expected to continue in the short term. Once the inventory adjustments are completed and a healthy primary market is restored, Eldorado expects to achieve a larger market share. Meanwhile, the size of the primary market is limited, and Eldorado will have to realize all opportunities for processing Canadian-mined uranium prior to export.

Another reason why lower earnings are anticipated in 1984 is the cost of servicing the debt assumed by the company over the past three years to finance its expansion program. Because Eldorado is a Crown corporation, its new assets have been financed without access to equity funds and most of the $450 million of expenditures to date has been paid for with borrowed capital. The interest on this debt was capitalized during construction. With new facilities coming into commercial production, however, interest costs charged against earnings will more than double in 1984 to some $55 million, an amount approximately equal to Eldorado's total annual payroll.

During 1983, Eldorado spent $137 million on construction projects in Saskatchewan and in Ontario. In Saskatchewan, the money was spent on new mine-mill development at both Key Lake and Collins Bay, which will bring Eldorado's annual productive mine capacity to 2,700 tonnes U. These production centres are among the most efficient and competitive in the world.

In Ontario, the company essentially completed its two major construction projects in 1983. The new Blind River refinery was built, commissioned and put into service by the fourth quarter, allowing the old refinery at Port Hope to be closed. Primary construction of the new uranium hexafluoride conversion plant at Port Hope was completed by year-end. Commissioning of the plant began in early 1984, and production is scheduled for mid-1984.

In addition, two significant steps were taken in 1983 to strengthen Eldorado's interests in the Rabbit Lake region over the long term. The first step was to gain approval from the Government of Saskatchewan for the company's plans to extend the operating life of the mill into the 1990s. Under the terms of a new surface lease agreement, Eldorado is developing the Collins Bay 'B' deposit, within a short trucking distance of the mill. Most of the $100 million in expenditures, however, are for modifications to the mill that are necessary to process a wider variety of ores and to meet environmental objectives. Development of the open pit mine and alterations to the mill are on schedule.

Eldorado further consolidated its interest in these properties by creating a new subsidiary that will acquire from the Aberford Group its 20 percent royalty interest in net profits from the Rabbit Lake mill and related orebodies. In return, the subsidiary will issue to Aberford $43.5 million in cumulative redeemable preferred shares bearing a 10 percent annual dividend and will pay $5 million in cash. Aberford may purchase, for $5 million, a five percent gross royalty on uranium revenue in excess of $30 (Cdn.) per pound from certain properties specified in the agreement. The net effect will be to allow Eldorado greater flexibility in the strategic use of its uranium assets and to permit both parties to share in the forecast improvement in the uranium market.

The uranium market is maturing, growing and highly commercial. It is now possible for Eldorado and its world-scale commercial assets to compete, not only in this important market for energy, but also in the market for the confidence and capital of investors. In conjunction with the Canada Development Investment Corporation, the company has completed a preliminary assessment of Eldorado and its prospects with a view to returning the company to the private sector. During 1984, a privatization strategy will be developed, that will ensure the Shareholder the best possible return for the assets of the company.

N.M. Ediger
Chairman and Chief Executive Officer

Operations Report

Eldorado produced record amounts of uranium mine concentrates during 1983. Concentrate production totalled 1,244 tonnes U, compared with 555 tonnes U produced by Eldorado from Rabbit Lake and Beaverlodge in 1982. The more than doubling of production reflects the company's first full year of operation of the Rabbit Lake mine and mill, acquired in October 1982.

In addition to production from Rabbit Lake by the Eldor Mines division, Eldorado received 72 tonnes U as its share of the output from the Key Lake mine and mill, which commenced operations in October 1983. In the first few months of production, the operator, Key Lake Mining Corporation, experienced some problems in the ore crushing plant as a result of high clay content in the ore. These problems will likely limit production in 1984. Modifications to the crushing plant are being made and it is anticipated that full-capacity operations will be achieved during the second half of 1984.

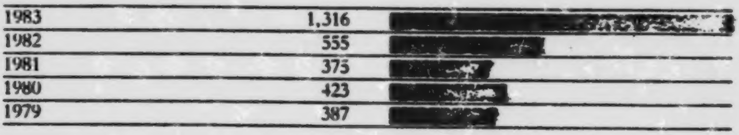
Work is well under way on the development of the new Collins Bay "B" uranium deposit, nine kilometres northeast of the existing Rabbit Lake mill. Some $26.4 million was spent on this project in 1983. Mining of the existing Rabbit Lake pit, which has been in production since 1975, is scheduled to be completed in the second quarter of 1984. The mill will then operate on stockpiled Rabbit Lake ore.

This project includes major modifications to the existing mill to allow the processing of the more complex ores from the Collins Bay orebody and other deposits nearby. The changes to the mill circuits will be completed by the fourth quarter of 1985, and the processing of the Collins Bay ore will commence when the stockpile from the Rabbit Lake pit has been exhausted. In addition to the new mine development and the mill modifications, the Rabbit Lake pit will be prepared as a facility for the disposal of future mill tailings. The Collins Bay development will return Eldor Mines' production capacity to 2,000 tonnes U annually.

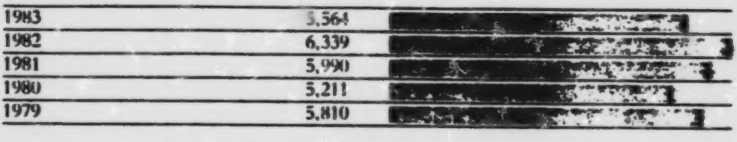
A plan for Eldorado's decommissioning of the Beaverlodge mine, closed down in mid-1982, was approved by the regulatory agencies and work is proceeding on schedule. The decommissioning work is expected to be completed by the middle of 1985, but some monitoring programs will continue beyond that date.

Uranium processed by the Fuel Services division last year declined by 12 percent to 5,564 tonnes U, largely the result of lower demand in the world market for uranium

Uranium Produced (tonnes U)



Uranium Processed (tonnes U)



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hexafluoride. Despite the lower volume, unit operating costs were maintained.

Some $30 million was spent during 1983 on the new uranium refinery at Blind River, Ontario, bringing total expenditures on this project to approximately $145 million. This facility, which was completed in July, refines concentrates received from mines in Canada and other countries. After a short commissioning period to test the design capacity and product quality, the refinery went into production in October.

The refined uranium trioxide is transported to Eldorado's conversion plants in Port Hope, Ontario, where it is converted into uranium hexafluoride or ceramic-grade uranium dioxide. At Port Hope, some $60 million was spent on the new uranium hexafluoride facility. This plant, which will have a capacity of 9,000 tonnes U, is scheduled to begin commercial production by mid-1984. Cost of the project to the end of 1983 was $120 million.

In addition to its mine production and uranium processing, Eldorado operates a Specialty Metals division in Port Hope. Sales of a variety of uranium and other specialized metal alloys from this division totalled $10.4 million, a decline from $13.5 million in 1982. Despite the depressed metal markets and reduced level of operations, the division continued to operate profitably.

The company's research and development group provided technical support in the commissioning of the Blind River plant and to other company operations. The group developed a new, low-cost process to recover uranium from the potassium diuranate scrap produced during the conversion process. Uranium is being recovered from a backlog of this material at Port Hope.

The exploration group continued its diversification program, directing its efforts to find deposits of minerals other than uranium. This diversification started in 1982 and is concentrated primarily on precious metals. The company is involved with joint venture partners on two significant gold projects in Ontario and Quebec. Fifty-eight percent of the $5 million exploration budget in 1983 was committed to non-uranium projects. Uranium exploration continues to focus on property held by the company in the region surrounding the Rabbit Lake mill.

Industrial safety performance in the Fuel Services and Eldor Mines divisions showed an improvement over 1982 in terms of both frequency and severity. Improving safety performance remains an important goal for Eldorado and its employees. Radiation exposure for employees in the operating divisions was well below regulatory levels set by government agencies.

Eldorado announced in November that as a result of market conditions, it would be necessary to reduce the Port Hope workforce during 1984. To achieve a reduction of about 100 positions, the company offered a voluntary early retirement program to its older employees, which will account for more than half of the reduction.

In 1984, the company will be in the second year of the federal six and five restraint program. Wages and salary increases are being held to within the five percent limit set by Parliament. During 1984 contracts will be negotiated with the two union locals representing the workforce at Port Hope. The employees involved in these contracts will have completed the second year of the restraint program on June 30.

Extraordinary market conditions and the introduction of new production facilities challenged the ingenuity of all employees during 1983. I would like to thank all employees for their co-operation and efforts to improve productivity. A continuing commitment to this objective will be required to ensure Eldorado's full participation in the highly-competitive uranium markets.

M. J. Moreau
Executive Vice-President and
Chief Operating Officer

Financial Review

Over the last few years Eldorado has undertaken a major financing program to support its capital expenditures. As a result, the management of cash has become a primary focus of financial management. In recognition of this and to provide the reader with a better appreciation of Eldorado's financial results, management has broadened the content of the funds statement to embrace all the financing and investing activities of the company and to reconcile the changes to cash rather than working capital.

Eldorado has also changed its methods of charging depreciation and foreign exchange. The depreciation change was made to more fairly allocate the costs of major capital facilities over their estimated useful lives. The change in method of recording foreign exchange was made to conform with the recently issued guidelines of the Canadian Institute of Chartered Accountants. Both of these changes have been applied retroactively to the financial statements.

Cash Position

Eldorado began the year with a significant cash balance of $148.8 million as a result of borrowing $228.3 million in the third quarter of 1982. The $148.8 million paid for 1983 additions to property and equipment, as well as the $5.1 million of debt maturing during the year.

During 1983, an additional $68.1 million of debt was raised to pay Eldorado's $39.5 million share of Key Lake Joint Venture cash calls and to pay the financing expenses of $20.9 million.

Cash generated from sales, showing a 57 percent increase over last year, plus the proceeds from the aircraft sale, amounted to $134.2 million. This cash was used to pay production costs of $87.5 million, royalties of $8.4 million plus all other cash operating and administrative costs for the year. Eldorado finished the year with a cash balance of $9,000.

Operating Results

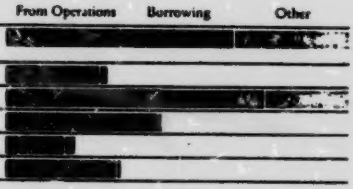
During 1983, Eldorado's financial position and performance were highlighted by record revenues of $154 million, a 73 percent increase over 1982; by a $6.4 million increase in net income to $10 million; and by a $36.7 million increase in its asset base.

Revenue

Eldorado's 73 percent increase in revenue to

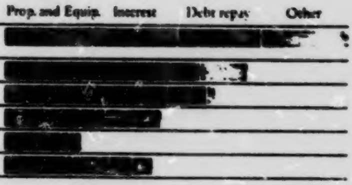
Cash Flow-Sources

1983	$112,256,000
1982	$371,257,000
1981	$168,843,000
1980	$ 76,915,000
1979	$127,339,000



Cash Flow-Uses

1983	$261,065,000
1982	$226,170,000
1981	$165,228,000
1980	$ 82,212,000
1979	$158,109,000



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$154 million was primarily due to a fourfold increase in mine concentrate sales, which was partially offset by lower revenues in both the Fuel Services and Specialty Metals divisions. These lower sales reflected weak market conditions in the conversion business and the loss of a major customer in Specialty Metals. Prices for all major products and services remained relatively firm throughout the year.

The higher mine concentrate sales volumes were attained despite the deferral of certain contracted sales to later years.

Earnings

Eldorado's 1983 consolidated net earnings were $10 million, a $6.4 million increase over 1982 (see note 3). Although the overall margin declined slightly, reflecting the weak conversion market, margins on mine concentrate sales improved, primarily due to the lower production cost orebodies acquired in late 1982. In 1983, interest charges amounted to $58.3 million, of which $37.4 million was capitalized. Comparable interest costs in 1982 were $45.5 million, of which $18.4 million was capitalized. This resulted in a $6.2 million decrease in financing expenses. Corporate expenditures on exploration, research and development, and administration continued at levels approximating those of 1982.

An interim decision with the Saskatchewan government on allocation of sales for royalty calculation purposes was reached. The results have been reflected in the 1983 financial statements.

Financial Position

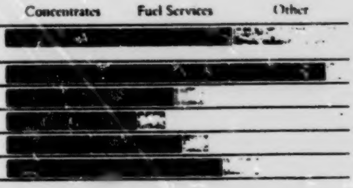
During 1983, Eldorado's asset base increased to $915.2 million. This was financed by new borrowings and cash generated from operations.

Capital Expenditures

In 1983, capital expenditures totalled $137.1 million, down from $239.9 million in 1982. In addition, $39.5 million was invested in Key Lake in 1983, an increase from $31.4 million in 1982. The Key Lake mine, of which Eldorado owns a one-sixth share, started up in October, 1983. Commercial production levels will be achieved in early 1984. Development has commenced on the Collins Bay "B" uranium deposit located within trucking distance of the Rabbit Lake mill.

The uranium processing expansion

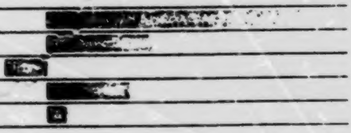
Revenue



1983	$154,047,000
1982	$ 88,818,000
1981	$ 71,888,000
1980	$ 91,116,000
1979	$111,498,000

Net Earnings

*Before extraordinary item



1983	$ 9,958,000
1982	$ 3,592,000
1981	$ (1,529,000)*
1980	$ 2,668,000
1979	$ 674,000

program is virtually complete. The new uranium trioxide refinery at Blind River will reach commercial production early in 1984. The new uranium hexafluoride conversion facility in Port Hope is expected to start-up by mid-1984.

With the closing of the Beaverlodge operations, the company's air transportation requirements changed and the Boeing 737 aircraft was no longer required. It was sold in early 1983, with the excess over book value being credited to the provision for mine shutdown.

Long-Term Debt

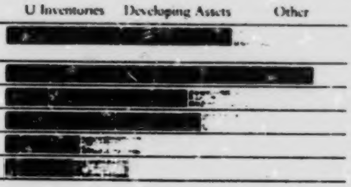
During the year, Eldorado issued $30 million of long-term debt. Long-term debt in 1983 was reduced by a repayment of $5.1 million and the assumption of the capitalized lease by the purchaser of the aircraft. Further long-term debt placement had been planned but was deferred to 1984 as the short-term debt market offered lower rates late in the year. A 1984 long-term debt placement will be used to replace the $80.1 million long-term debt due in 1984 and the $38.1 million bank advances outstanding at December 31, 1983.

Share Capital

In January 1983, the Government of Canada transferred the ownership of its Eldorado shares to the Canada Development Investment Corporation (CDIC). Subsequently, a re-organization of capital reduced total share capital by $10 million which was paid to the

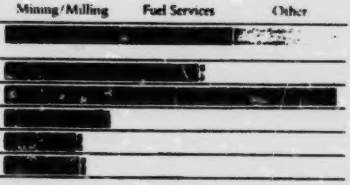
Assets

1983	$915,204,000
1982	$878,556,000
1981	$620,530,000
1980	$360,557,000
1979	$326,241,000



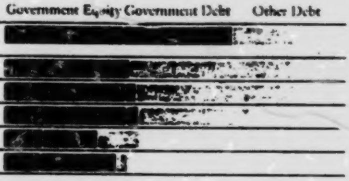
Capital Expenditures

1983	$137,115,000
1982	$239,862,000
1981	$ 75,111,000
1980	$ 53,949,000
1979	$ 56,296,000



Equity and Long-Term Debt

	% Equity	Equity and Debt
1983	37	$697,747,000
1982	36	$718,024,000
1981	48	$520,154,000
1980	29	$288,038,000
1979	31	$263,473,000



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Shareholder. A share exchange, described in more detail in note 11, resulted in the current balance of 800,000 preference shares and 3,852,880 common shares. The dividend on the old preferred shares was cumulative whereas the new shares are non-cumulative. This relieved the company of large dividend payments scheduled in 1986 and 1987. Also, the new shares carry a lower dividend and are redeemable by either party.

Income Tax

Eldorado is subject to the full provisions of the Income Tax Act and does not receive any special consideration because of its ownership by the Crown. The company's current tax banks were sufficient to preclude the payment of income taxes in 1983.

Saskatchewan Uranium Royalties

The company is subject to the full provisions of the Saskatchewan Mineral Resources Act for the payment of uranium royalties. Provincial mineral royalty payments are not deductible from income for determining the federal income taxes payable.

T.J. Gorman
Vice-President, Finance

Report of Management's Accountability

The accompanying consolidated financial statements and all information in the Annual Report are the responsibility of management and the Board of Directors of the company. The financial statements were prepared by management in conformity with Canadian generally accepted accounting principles considered to be appropriate in the circumstances.

Eldorado maintains internal accounting controls which are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use, and that reliable financial information is produced. To prevent conflicts of interest on the part of employees and to ensure that there is no unauthorized disclosure by employees of confidential information, the company also has a "Code of Ethics". The company has an internal auditing department, whose functions include reviewing the systems of control to ensure they are adequate and functioning properly.

Annually, the consolidated financial statements are examined by the company's external auditors. Their examination is made in accordance with generally accepted auditing standards and includes a review and evaluation of the company's system of internal accounting controls and such tests and other procedures as they deem necessary to provide reasonable assurance as to the fairness of the financial statements.

The Board of Directors, through its Audit Committee, is responsible for reviewing and monitoring the company's accounting and reporting practices. The Audit Committee, comprised solely of outside directors, meets with management and both the internal and external auditors to satisfy itself that their responsibilities are properly discharged. Both the internal and external auditors have free access to this committee to discuss the results of their work and their opinions on the adequacy of the internal accounting controls and the quality of financial reporting.

Statement of Changes in Consolidated Financial Position

For the year ended December 31st	1983	1982
	(Thousands of dollars)	
Sources of funds		
Revenue	$ 154,047	$ 88,818
Decrease (increase) to accounts receivable	(21,356)	(4,156)
	132,691	*84,662*
Increase to debt	68,108	268,845
Working capital received on acquisition	—	85,497
Disposal of aircraft	1,500	—
Interest income on investments	5,882	7,945
Total sources of funds	208,181	446,949
Applications of funds		
Production costs	87,516	71,719
Royalties	8,419	3,886
Financing expense	20,938	27,114
R & D, exploration and administration	14,094	14,013
Additions to property and equipment	143,304	117,874
Investment in joint venture	39,461	31,396
Additions to deferred charges	10,491	3,642
Debt repayment	5,201	41,371
Reduction of share capital	10,000	—
Increase (decrease) to taxes receivable	737	—
Increase (decrease) to supplies and prepaids	(41)	(868)
Decrease (increase) to accounts payable	7,019	(23,423)
Beaverlodge shutdown	9,698	13,100
Other	126	2,051
Total applications of funds	356,963	301,875
Net increase (decrease) to cash	(148,782)	145,074
Cash balance at beginning of year	148,791	3,717
Cash balance at end of year	$ 9	$148,791
Net increase (decrease) to cash represented by:		
Funds generated from operations	$ 36,756	$ 9,057
Other sources (applications) of funds	(185,538)	136,017
Net increase (decrease) to funds	$(148,782)	$145,074

The accompanying notes to Consolidated Financial Statements are an integral part of this statement.

Statement of Consolidated Earnings and Retained Earnings

For the year ended December 31st	1983	1982
	(Thousands of dollars)	
Revenue		
Sales of products and services	$154,047	$ 88,818
Expenses		
Cost of products and services sold	103,653	57,810
Exploration	5,015	5,495
Research and development	2,645	2,780
Administration	6,875	6,281
Financing expense	20,938	27,114
Other expense (income)	(3,456)	(18,140)
Total expenses	135,670	81,340
Earnings before taxes	18,377	7,478
Income taxes and mineral royalties	8,419	3,886
Net earnings	9,958	3,592
Retained earnings (deficit) as restated	(48,763)	(52,355)
Retained earnings (deficit) at end of year	$(38,805)	$(48,763)

The accompanying notes to Consolidated Financial Statements are an integral part of this statement.

Statement of Consolidated Financial Position

As at December 31st	1983	1982
	(Thousands of dollars)	
Current assets		
Cash and short-term investments	$ 9	$148,791
Accounts receivable	41,437	20,081
Income taxes receivable	26,171	25,434
Mine concentrates on loan	—	1,572
Inventories	111,228	113,846
Supplies	9,762	9,800
Prepaid expenses	197	200
	188,804	*319,724*
Current liabilities		
Bank loans and advances	38,108	—
Accounts payable	48,566	55,585
Long-term debt due within one year	80,093	47,167
Provision for mine shutdown	28,920	32,937
	195,687	*135,689*
Working capital (deficiency)	(6,883)	184,035
Non-current assets		
Investment in joint venture	202,064	162,603
Property and equipment	504,715	376,843
Deferred charges	15,981	6,525
Other assets	3,641	12,861
	726,401	*558,832*
Capital employed	$719,518	$742,867
Represented by:		
Long-term debt	$439,956	$460,201
Other liabilities	510	3,938
Provision for reclamation	21,271	20,905
	461,737	*485,044*
Shareholder's equity		
Share capital	296,586	306,586
Retained earnings (deficit)	(38,805)	(48,763)
	257,781	*257,823*
Total financing of capital	$719,518	$742,867

The accompanying notes to Consolidated Financial Statements are an integral part of this statement.

Approved by the Board of Directors.

Marcel Bélanger

Notes to Consolidated Financial Statements
for the year ended December 31st, 1983

1. Eldorado Nuclear Limited

Eldorado Nuclear Limited is incorporated under the Canada Business Corporations Act, is subject to the Financial Administration Act, the Government Companies Operations Act, is an agent of Her Majesty in Right of Canada, and is wholly-owned by Canada Development Investment Corporation (CDIC).

The company is primarily engaged in the mining, refining and conversion of uranium for sale as fuel for generating electricity in nuclear power reactors in Canada and other countries.

On October 1, 1982, the company acquired all of the outstanding shares of Gulf Minerals Canada Limited and Uranerz Canada Limited. These two companies were joint owners of the Rabbit Lake mining operations in northern Saskatchewan. In addition, Gulf was the owner of various undeveloped orebodies in the region. The results of the Rabbit Lake operations since the date of acquisition have been included in the Consolidated Financial Statements.

2. Accounting Policies

A statement of significant accounting policies of the company is provided on page 30.

3. Changes in Accounting Policies

The company has retroactively changed its method of accounting for depreciation and foreign exchange.

Except for certain old uranium processing assets, the method of depreciation for processing assets changed from the composite straight-line method to the unit of production method. The company feels this method appropriately depreciates the assets over their useful lives and is consistent with the method used to depreciate mining assets. As a result, the balance of retained earnings at January 1, 1983 has been adjusted by the cumulative amount by which depreciation has been adjusted. Of the adjustment, $778,000 is applicable to 1982 and has been charged to 1982 income. The remainder is applicable to years prior to January 1, 1982, and the balance of retained earnings at that date has been adjusted accordingly.

Long-term debt denominated in foreign currencies has been translated into Canadian dollars at the rate of exchange in effect at December 31, 1983 and retroactively to December 31, 1982. Consequently, the balance of retained earnings at January 1, 1983 has been adjusted by the cumulative amount by which foreign exchange gains and losses have been deferred and amortized. Of the adjustment, $1,186,000 is applicable to 1982 and has been charged to 1982 income. The remainder is applicable to years prior to January 1, 1982, and the balance of retained earnings at that date has been adjusted accordingly.

As a result, retained earnings have been restated as follows:

For the year ended December 31st	1983	1982
	(Thousands of dollars)	
Retained earnings (deficit) at beginning of year		
As previously reported	$ (50,123)	$ (54,123)
As restated for change in accounting for:		
depreciation	2,931	2,153
foreign exchange	(1,571)	(385)
As restated	$ (48,763)	$ (52,355)

4. Other Expense and Income

For the year ended December 31st	1983	1982
	(Thousands of dollars)	
Income		
Interest on investments	$ 5,882	$ 7,945
Gain on disposal on non-current inventory	—	12,036
Settlement of other liability	3,428	—
Other non-operating items	231	2,231
Expenses		
Non-operating items	(4,130)	(2,886)
Gain (loss) on foreign exchange	(1,955)	(1,186)
Total	$ 3,456	$18,140

5. Income Taxes and Mineral Royalties

The provisions for income taxes and mineral royalties were as follows:

For the year ended December 31st	1983	1982
	(Thousands of dollars)	
Income taxes	$ —	$ —
Mineral royalties	8,419	3,886
Total	$ 8,419	$ 3,886

The reconciliation between the statutory income tax rate and the company's effective rate of income tax and mineral royalties is as follows:

Percentage of pre-tax earnings	1983	1982
Statutory income tax (recovery) rate	50.9%	51.8%
Resource and depletion allowances	(31.1)	(56.2)
Adjusted income tax (recovery) rate	19.8	(4.4)
Inventory allowance	(9.5)	(53.6)
Non-deductibility of income debenture interest	6.9	21.4
Other	(17.2)	36.6
Effective income tax (recovery) rate	0.0	0.0
Mineral royalties	45.8	52.0
Net effective tax (recovery) rate	45.8%	52.0%

Provincial mineral royalties, which are not deductible for federal income tax purposes, are calculated in part as a percentage of revenues and consequently the effective rate can fluctuate significantly from year to year.

At December 31, 1983, the company had unrecorded income tax debits of approximately $50 million to be applied against future taxable earnings. These debits arise from depreciation costs exceeding capital cost allowance claims, from expenditures on assets qualifying for an earned depletion tax deduction, and from expenditures qualifying for investment tax credits.

6. Inventories

As at December 31st	1983	1982
	(Thousands of dollars)	
Mine concentrates	$ 87,496	$ 95,895
Fuel Services	22,498	16,794
Specialty Metals	1,234	1,157
Total	$111,228	$113,846

7. Property and Equipment

As at December 31st	1983	1982
	(Thousands of dollars)	
Mining		
existing	$ 122,655	$ 119,276
under development	26,396	—
Fuel Services		
existing	77,012	76,874
under construction	325,724	210,800
Other	18,149	19,683
Total property and equipment	569,936	426,633
Less: accumulated depreciation	65,222	49,790
Net property and equipment	$ 504,714	$ 376,843
Depreciation for year	$ 15,432	$ 9,581

8. Deferred Charges

As at December 31st	1983	1982
	(Thousands of dollars)	
Processing preproduction	$ 11,524	$ 1,485
Unamortized financing costs	4,457	5,040
Total	$ 15,981	$ 6,525
Amortization for year	$ 1,035	$ 955

9. Other Assets

With the closing of the Beaverlodge mine in 1982, the requirements for air transportation decreased substantially. At that time the Boeing 737 aircraft was reclassified from Property and Equipment to Other Assets. In early 1983, the aircraft was sold and the capital lease, which was to expire in 1992, was assumed by the purchaser.

10. Long-Term Debt

As at December 31st	1983	1982
	(Thousands of dollars)	
i) From Canada		
5.875% notes due 1983	$ —	$ 5,082
6.375% notes due 1984	10,093	10,093
ii) Other		
Income debentures due January 3, 1984, at floating rate approximately one-half of prime lending rate	40,000	40,000
Capitalized lease expiring 1992, with floating monthly payments 2%-4% below prime lending rate	—	14,024
Notes due 1986, at 13.25% ($U.S. – 50 million)	62,220	61,470
Loan due 1991, at 7% (100 million Swiss francs)	57,110	61,150
Notes due 1988, at interest rate to yield 9.19% (10.108 billion Japanese yen)	54,330	52,966
Loan due 1987-1992, at 8.8% (2 billion Japanese yen)	10,750	10,480
Notes due 1992, at 14.5% ($U.S.– 100 million)	124,440	122,940
Loan due 1992, at an interest rate to yield 14.25% ($U.S. – 44.7 million)	55,562	54,894
Bonds due 1992, at 8.5% (10 billion Japanese yen), with 10% of principal due in each of years 1988-1991	53,750	52,400
Promissory note due 1984, at floating rate 0.35% above 90-day Treasury Bill rate	30,000	30,000
Debenture due 1988, at 11%	30,000	—
Sub-total	528,255	515,499
Less: Current portion of long-term debt listed above	80,093	47,167
Deferred loss on foreign exchange	8,206	8,131
Total	$ 439,956	$ 460,201

10. a) Current Portion of Long-Term Debt

Included in the 1983 and 1982 current portion of long-term debt is a $40 million income debenture at a floating rate approximately one-half of the prime lending rate. In late 1983, this debenture, due Saturday December 31, 1983, was rescheduled to be due and payable on the first business day in 1984.

10. b) Long-Term Debt Payments

The long-term debt payments due in each of the next five years are as follows: 1984-$80,093,000; 1985-nil; 1986-$62,220,000; 1987-$1,075,000; 1988-$91,855,000.

11. Share Capital

As at December 31st	1983	1982
Authorized:		
Common shares	Unlimited number no par value	
Preferred shares	—	1,600,000
Preference shares	1,600,000	—
	(Thousands of dollars)	
Issued and fully paid:		
Common – 3,852,880 shares (1982 – 1,452,880)	$ 201,586	$ 106,586
Preferred – nil (1982 – 1,600,000)	—	200,000
Preference – 800,000 shares (1982 – nil)	95,000	—
	$ 296,586	$ 306,586

On January 20, 1983, the federal government transferred its ownership of Eldorado's common and preferred shares to the Canada Development Investment Corporation (CDIC).

On May 3, 1983, a reorganization of share capital reduced total share capital by $10 million which was paid to the Shareholder. At the same time, 1.6 million preferred shares were exchanged for an equal number of preference shares. Under a conversion privilege which expired during 1983, the Shareholder converted 800,000 preference shares into 2.4 million common shares. Each new preference share carries a non-cumulative dividend of $7.125 per annum. In addition, they are redeemable at the option of either party at a value of $118.75 each.

12. Commitments and Contingencies

a) The company has entered into long-term leases on certain properties up to 1987 with annual rental payments averaging $567,000.

b) The company has defined benefit pension plans covering all of its regular full-time employees.

The pension funds, which are administered by independent trustees, are valued at least every three years by consulting actuaries. Based on the most recent actuarial valuations, the plans have a total current surplus of $7,484,000 (1982 - $5,006,000). The effective dates of the most recent actuarial reports were June 30, 1983 and July 1, 1982.

c) Through a wholly-owned subsidiary, the company is a one-sixth partner in a joint venture mining operation at Key Lake, Saskatchewan. In accordance with the joint venture agreement, Eldorado is obligated to meet its proportionate share of the commitments of the joint venture. Aside from normal operating expenditures, the company has no outstanding commitments as at December 31, 1983.

d) The company's expansion of its refining and conversion capacity will be completed in 1984. The UO_3 plant at Blind River was substantially completed in 1983 and the capital cost to bring the new UF_6 conversion plant into production in 1984 is projected at approximately $4 million. Commercial production of these facilities is anticipated in 1984.

e) In connection with its operation, the company is the defendant in certain litigation. It is the opinion of management, based on legal counsel, that this will not result in any material liabilities to the company.

13. Supplementary Information

a) During 1983 the company paid sales commissions to Marubeni Corporation, Toyomenka Canada Ltd., and Uranerzbergbau-GmbH.

b) Interest costs of $37.4 million paid in 1983 have been capitalized under property and equipment (1982-$18.4 million).

c) Fees paid in 1983 to the eight Directors who are not Officers amounted to $79,709. Any Officer who is also a Director is not compensated for service as a member of the Board or its committees. Salaries paid to the seven Officers in 1983 totalled $697,203. No bonuses were paid.

The estimated aggregate cost to Eldorado in the financial year ended December 31, 1983 of all pension benefits proposed to be paid to Officers under the existing Eldorado Pension Plan upon retirement at normal retirement age was $60,270. Directors who are not Officers do not participate in the pension plan.

Under Eldorado's employee relocation policy, three Officers have mortgage loans amounting to $185,000. Payments of principal and interest on these mortgages amounted to $20,197 in 1983.

14. Segmented Information

a) Industry Segment:
The company is of the opinion that virtually all its sales revenues are in the industry segment identified as the nuclear fuel industry.

b) Sales:
Sales revenues of the company are derived primarily from sales to foreign and domestic electric utilities as follows:

For the year ended December 31st	1983	1982
	(Thousands of dollars)	
Export sales	$ 107,362	$ 66,143
Domestic sales	46,685	22,675
Total sales	$ 154,047	$ 88,818

15. Provision for Mine Shutdown

Established in 1981, the provision for the Beaverlodge mine shutdown represents the expected remaining cost of decommissioning and reclaiming the Beaverlodge mine.

16. Subsequent Event

In February, 1984, Eldorado arranged an issue of U.S. $100 million Eurodollar notes due in 1989. The interest rate is the six-month London inter-bank offered rate. The notes may be called by Eldorado in or after February, 1985. The net proceeds are being added to the general funds of Eldorado and used to repay certain borrowings and to fund the company's capital expenditure program.

Statement of Accounting Policies

The accompanying consolidated financial statements were prepared by management in conformance with Canadian generally accepted accounting principles considered to be appropriate in the circumstances, after giving retroactive effect to the changes in the method of recording foreign exchange and depreciation, and have been applied on a basis consistent with that of the preceding year. A summary of significant accounting policies of the company is presented to assist the reader in interpreting the statements contained herein.

Consolidation
The consolidated financial statements include the accounts of Eldorado Nuclear Limited and its wholly-owned subsidiaries.

Inventories
Inventories of mine concentrates, refined and converted products are valued at the lower of weighted average cost or net realizable value. Cost for customer-owned products is the cost of the refining and conversion processes only.

Inventories of mine concentrates are initially measured and accounted for in the financial statements when the material is sealed in containers upon completion of the milling process.

Supplies
Operating and general supplies are carried at lower of cost or market.

Property and Equipment
Assets are carried at cost. Costs of additions, betterments, and renewals are capitalized. When assets are retired or sold, the resulting gains or losses are reflected in current earnings.

Maintenance and repair expenditures are charged to cost of production.

Investment in Joint Venture
The investment in joint venture, which consists of exploration, development, capital and financing costs of the one-sixth interest in the Key Lake orebodies, is carried at cost.

Depreciation
Except for certain old conversion and refining facilities at Port Hope, the processing and mining buildings and equipment are depreciated according to the unit-of-production method. This method allocates the cost of these assets to each accounting period according to the portion of the processing facilities' total estimated lifetime production recovered in that period in the case of processing assets and the mine's total estimated ore reserves recovered in that period in the case of mining assets.

Mobile mining equipment, old conversion and refining assets and other assets are depreciated according to the composite straight-line method based on the estimated useful lives of these assets, which ranges from three to 10 years.

Capitalization of Interest
Interest costs on funds borrowed to finance the development and construction of major assets are capitalized during the development and construction period until such time as a commercial level of production is achieved.

Mine Development and Preproduction Costs
Certain mine development and processing facility costs associated with capacity additions are deferred until a commercial level of production is achieved. These costs are then amortized over 10 years in the case of processing assets, and according to the unit-of-production method in the case of mining assets. Other costs are charged to production as incurred.

Unamortized Financing Costs
Debt discounts and issue expenses associated with long-term financing are deferred and amortized over the term of the debt.

Provision for Reclamation
The estimated costs of decommissioning and reclaiming producing resource properties are accrued and charged to operations according to the unit-of-production method. Actual costs of decommissioning and reclamation are applied to this accrual.

Research and Development and Exploration Costs
Expenditures for applied research and development relative to the products and processes of the company and expenditures for geological exploration programs are charged against earnings as incurred.

Sales of Products and Services
In accordance with normal industry practices, the company contracts for future delivery of mine concentrates and conversion services. Sales revenue is recorded in the fiscal year that title passes or, with customer-owned material, when delivery is effected.

Foreign Exchange
Cash and short-term investments, accounts receivable, accounts payable and long-term debt denominated in foreign currencies are translated into Canadian dollars at rates of exchange in effect at year-end. Income and expenses are translated at rates in effect at the time of the transaction.

For long-term debt denominated in a foreign currency, the change in value in Canadian funds over the year is amortized evenly over the remaining life of the debt. For all other accounts, gains or losses resulting from foreign currency translation are reflected in the statement of consolidated earnings and retained earnings.

Income Tax
The company follows the tax allocation method of providing for income taxes. Taxable income may be different from reported earnings before taxes because certain items of income and expense are recorded in time periods different for tax purposes from those for financial reporting purposes. The difference between the taxes calculated as payable each year and those charged against earnings on the tax allocation method is accumulated and carried forward in the statement of consolidated financial position under the caption Deferred Taxes.

STATEMENT OF HON. JOHN D. DINGELL

Mr. Chairman, I am delighted that you have found the time to hold another hearing on this important legislation before our Committee. U.S. trade problems continue to worsen. We have experienced unprecedented trade deficits that show no sign of improvement. Recently, we became a debtor nation for the first time since 1914.

The Administration's very recent attempts to address the nation's trade problems are simply too little, too late. Initiating further investigations, instead of acting on the abundance of proof available on unfair foreign trade practices, demonstrates how shallow and tenuous the Administration's new "commitment" really is.

The Administration's unwillingness to develop a coherent trade policy that provides for the nation's long-term economic interests is at the heart of the problem. Therefore, it is up to the Congress to develop trade laws that ensure fair treatment of U.S. firms and U.S. workers.

I join my colleagues in welcoming the distinguished sponsor of H.R. 1950. The Trade Law Modernization Act, to this hearing today. The trade law changes proposed in that bill represent an extremely useful and needed step in addressing our Nation's trade problems. I hope that the Chairman will schedule markup on this vital legislation at the earliest possible date, so that we can help U.S. firms and workers combat unfair trade practices and preserve the Nation's industrial base.

I look forward to hearing the testimony of our distinguished witnesses today.

Mr. RICHARDSON. I would like the subcommittee to know that I will be offering amendments in this area when we go to markup session, relating to Mexico also. I can't disclose them now, because I haven't drafted them.

But, Mr. Chairman, I thank you for allowing me these 2 minutes. I have to run.

Mr. FLORIO. Thank you very much. Mr. Feketekuty, we appreciate your appearance again. I have practiced on your name, and I hope that my practice has been worthwhile.

Thank you very much.

Mr. FEKETEKUTY. Thank you, Mr. Chairman

Mr. FLORIO. We are now pleased to have back with us again as a witness Mr. Fred Bergsten, the Director for the Institute for International Economics.

We welcome you to our subcommittee. Your statement will be made a part of the record in its entirety. Please feel free to proceed.

STATEMENT OF C. FRED BERGSTEN, DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. BERGSTEN. Thank you very much, Mr. Chairman.

In your letter of invitation, you asked me to speak about the effects of the exchange rate problem on the trade balance and asked particularly for an evaluation of the rather important new developments in that area with the administration's announcement 10 days ago of a new effort to deal with the exchange rate policy, particularly through market intervention. So I will focus on those topics in my comments, as I did in my statement, and then I will be happy to answer any questions you may have.

When I appeared before the subcommittee about 18 months ago, I made some predictions, which all too unfortunately turned out to be correct, about the further huge deterioration in the U.S. trade and current account positions that were coming. The results have now become almost household numbers, to the extent that anything in this business ever is, with a merchandise trade deficit this year probably hitting about $150 billion on the Commerce Monthly

Series basis, and the current account deficit probably coming in at around $125 billion.

In my view, the great bulk of this problem, something like three-quarters of the deterioration of the U.S. trade position since 1981, is due to the strength of the dollar in the exchange markets. And on our calculation, prior to the new intervention program announced 10 days ago, the exchange rate of the dollar had become overvalued relative to the underlying competitive position of the United States by something like 30 to 35 percent. This means that we are essentially taxing all of our exports 30 to 35 percent, and we are essentially subsidizing all imports coming into the country 30 to 35 percent through the exchange rate. That has been responsible for the lion's share of the deterioration in our trade performance, with all its adverse effects on the economy.

Now I and my colleagues at the Institute have projected the situation forward, and asked ourselves, "Suppose the exchange rate stayed at that recent level? Where would it be taking the U.S. economy?" And some of the answers are shocking.

If the dollar had stayed at the level that existed prior to the new package ten 10 ago, our current account deficit would have continued to rise steadily to something like $300 billion annually by the end of this decade. That would have been made up of a merchandise trade deficit of about $200 billion and net interest payments of about $100 billion, as we become a massive net debtor country, which would have taken our net foreign debt to something like a trillion dollars by the end of the decade and rising fast.

So that is the baseline against which one should compare the efforts launched 10 days ago—a dollar overvalued by 30 to 35 percent, heading toward a current account deficit of $300 billion and a net foreign debt of a trillion dollars by the end of the decade.

The program the administration launched on September 22, which at least begins to seek to correct the dollar misalignment, is this of critical importance for the future of the whole economy and for trade policy, the topics that you are talking about here.

I would submit that the initial results are encouraging. During the first week to 10 days of the new effort, the program has produced an average correction of about 5 percent in the dollar rate, but more importantly, perhaps, a move of a little more than 10 percent against the Japanese yen. Let me suggest why that is important.

Every percentage point move in the trade weighted average exchange weight of the dollar can be expected to improve our trade balance by about $3 billion. It takes a year to two for those effects to play through fully, but the historical record is pretty clear. Every percentage point in the exchange rate globally gets you about $3 billion.

We have run some new estimates, which I wouldn't pretend yet to be as fully reliable as the one I just mentioned, but we have tried to do the impact of the bilateral yen/dollar rate on bilateral United States-Japan trade. There we conclude that every percentage point of strengthening of the yen against the dollar will improve our trade balance against Japan bilaterally by about $800 million, again taking a year to two to play through but a significant amount.

So those exchange rate changes that have already taken place over the last 10 days can already be expected to provide some significant relief to the huge trade deficit. However, I don't want to wax too euphoric because it's only a very modest beginning. Even with the correction of the dollar that was already underway in the market since about the end of February this year, but has now been given a push by the intervention of the last 10 days, the dollar is still only 2 to 4 percent below its average value for 1984. That means that we have only begun to see a modest correction in that underlying trend I mentioned at the outset.

Therefore, contrary to assertions that have been emanating recently from the Commerce Department and some private forecasters, I would fear that we are still on a path of steadily rising current account deficits. On these exchange rates they wouldn't reach $300 billion by the end of the decade, but they would still reach something like $250 billion. So the deficit has been cut by a significant amount, but it still is very large and obviously leaves a long way to go.

I would also stress the timing point, because patience is of essence in this business. I have argued that the basic problem of the trade deficit is the exchange rate. I have suggested that big exchange rate change is needed, therefore, to correct it. But even when you get big exchange rate changes, even if you and I could wave a wand and get the dollar at new equilibrium levels tomorrow, it would still take 1 to 2 years before the full effects were to play through.

So, as of this point in late 1985, even under the best of worlds, one is not going to see much improvement in 1986. Although order books will start to show better export orders and, import competing industries will begin to see their order books look better, and some improvement would begin to show up toward the latter part of next year, it really would be into 1987 before large-scale improvement could be expected.

I think that is terribly important for everybody to have in mind or else one tends to get too impatient with the failure of results to show up overnight.

Having laid out the baseline, and applauding the effort that has begun to be made to address the trade problem in the correct manner by recognizing that dollar overvaluation is the core of the problem and at least starting to address it, I would go on to note that it is essential that the effort begun 10 days ago be pursued vigorously over the coming weeks and months and, indeed, be extended to more fundamental changes in economic policy.

I would submit that the target, the objective of the exercise, should be a further correction of something like 25 to 30 percent in the trade-weighted exchange rate of the dollar, for the reason that I mentioned. If we are going to get a substantial correction in a deficit that this year will hit about $150 billion and continues to rise, a substantial exchange rate move is needed.

I believe, contrary to some people that you may hear from, that coordinated and skillful intervention in the exchange markets of the type that was launched ten days ago can promote the needed changes. It is instructive to note that the yen, which is, of course, the most important for our trade and which normally moves much less against the dollar than the European currencies, has, in fact, moved twice as much as they have over these last 10 days.

I think the reason is simple. The Japanese have intervened much more heavily than the Europeans. They have put almost $1 billion into the exchange markets on a couple of days in this period, and they have simply pushed the yen rate in a substantially strengthening direction.

The yen, which tends not to move very fast very much, has risen in value in the exchange markets from something like 240 to the dollar only 2 weeks ago to about 214 to the dollar. That is a move of over 10 percent in 10 days. It's a big move in terms of exchange markets, particularly for the yen, which suggests to me that the heavy Japanese intervention, supported by the United States, has had a big effect. It demonstrates intervention can work and therefore should be applauded but be encouraged to go further.

There are skeptics, as I mentioned, who doubt that intervention can have much lasting impact. But it seems to me that there has been a very large measure of what economists call speculative bubble in the exchange markets. If this new program, indicating guidance to the market from official quarters and a sense of clear resolve on the part of officials both here and abroad to get the exchange rates moved toward an underlying balance, can be maintained, forcefully reminding the traders that the fundamental economics have for a long time pointed to a lower exchange rate for the dollar, then I think intervention can have a substantial effect.

Most previous intervention strategies have, in fact, been very different from what is now being tried, as I read it. In the past, governments and central banks have carried out intervention via what is called "leaning against the wind." What they have basically tried to do is resist day-to-day volatility in the exchange markets by trying to slow down market trends. If the dollar was rising very fast, they would come in against its rise to try to keep it from rising so much in the interest of day-to-day stability in the market.

However, the intervention that is now going on is what I call "leaning with the wind" intervention. The dollar was already coming off substantially since last February. It had already corrected by about 10 percent in the markets. Before the effort of 10 days ago was announced, the dollar had begun again to go down, so the officials were now leaning with the wind. They were working with underlying market trends, trying to push them further and faster to get the correction that was needed to adjust our trade balance and head off trade policies that might be destructive of broader interests.

They are also, I think, in this exercise not simply trying to affect the day-to-day volatility of the market; they are trying to change the level of the exchange rate. They are trying to get a stronger yen, a stronger deutschemark, a dollar which more accurately reflects the underlying competitive position of the United States.

So in fundmental regards, I think what the administration and the central banks are now doing is different from what has been done in the past, and therefore, I think, has a significant chance to succeed.

I would stress particularly for the committee that the role of the United States will be critical to the success of the intervention strategy. The administration has made a major contribution to the initial gains from the effort by indicating publicly for the first time, and indeed, with great fanfare 10 days ago that it wanted to see a dollar correction. That is a big change in policy.

It pledged active participation in the market operation, and it is judged so far to be doing so adequately. But any flagging of participation by the Federal Reserve on instruction from the administration would be seen as a relapse to the previous U.S. disinterest in exchange rate configuration and would probably torpedo the entire exercise.

Now, going beyond this, let me mention quickly what I think ought to be done to follow up. The next logical step would be a further easing of U.S. monetary policy. I think the domestic economic conditions of a relatively soft economy and inflation clearly under control, with some fragility in many of our financial markets both at home and abroad, call for a further easing of monetary policy in any event.

But I think if the Federal Reserve would now ease interest rates a bit further, coming on top of this intervention strategy and an indication of desire to see an exchange rate correction, that could be the second shoe dropping and have a very favorable impact in pushing further the desirable correction.

For the longer run, however, it is still going to be necessary to do what has proven so difficult here in the Congress and with the administration, which is to bring the U.S. budget deficit down.

Now again, contrary to what you may hear from some, I would argue that it is quite possible to bring the U.S. dollar and the trade deficit into correction without correcting the budget deficit, and I think the action of the last few days already shows that can happen.

Doing so, however, is decidedly less desirable than doing so with the correction of the budget deficit because, with the lower trade deficit and lower capital inflow, the domestic economy would be squeezed out and higher interest rates would result as long as the budget deficit stays so high once private investment and the private sector of the economy begin to pick up again. So a nasty situation could result if the budget deficit is not brought under control.

Finally, let me draw a couple of implications for trade policy from what has been happening on this exchange rate and trade deficit front. The huge and growing trade deficit, it seems to me, is the main source of the enormous pressure for major changes in trade policy such as those you have been considering so actively here in the committee.

I would submit that the overvalued dollar is clearly the major source of the trade deficit. Hence the outcome of the new intervention program and future steps to deal with the trade deficit through the dollar have major implications for trade policy. -

I stress this because I would argue that the trade deficit and trade policy, at least as trade policy is normally defined, are two very different phenomena. As I have mentioned, the trade deficit is caused almost wholly by monetary and macroeconomic phenomena: the exchange rate, U.S. budget deficits, economic growth rates here and abroad, and the like.

Trade policy actions, such as pressure on other countries to open their markets and consideration of new import restraints here, are clearly of great importance for individual industries in this country and for the successful implementation of a trading system. But even if those measures on trade policy were totally successful, they would have relatively little impact on the trade deficit.

We have made extensive studies of the Japanese situation, the greatest concern that most of us would have in terms of foreign trade barriers. We have cut it every which way we can. We have looked at many individual sectors. We have analyzed it from many perspectives, and we have concluded that even if the Japanese got rid of all their barriers, their intangible and covert barriers as well as those that are clearly on the books, U.S. exports would not grow by more than $5 billion to $8 billion.

Now that is a lot. It is certainly worth going after. It would be critically important for many industries. But it would only put a modest dent in our global trade deficit of $150 billion, and it wouldn't even put a huge dent in our bilateral deficit with Japan of $50 billion.

I don't in any way want to denigrate efforts to go after those problems as you are trying to in the committee. Again, I simply want to make sure that nobody has the wrong impression that those are going to do a great deal to bring the trade deficit down.

So I would conclude, Mr. Chairman, by simply reiterating that as you go after the trade deficit, in addition to the more sector-specific issues, I think you have to push very hard on the administration to make sure that what it began 10 days ago continues to be implemented vigorously, that it takes the next steps to follow up and make sure that a substantial correction of the dollar and therefore the overall competitive position of the United States is, in fact, achieved.

Thank you.

[The prepared statement of Mr. Bergsten follows:]

THE NEW DOLLAR PROGRAM AND US TRADE POLICY

Statement by C. Fred Bergsten
Director
Institute for International Economics
Before the
Subcommittee on Commerce, Transportation and Tourism
Committee on Energy and Commerce
US House of Representatives
October 3, 1985

The Outlook for the Trade Deficit

As I predicted to this Committee in March 1984, all too accurately, the overvaluation of the dollar has produced a US merchandise trade deficit which exceeded $120 billion in 1984 and will approach $150 billion this year. As I also predicted, the current account deficit exceeded $100 billion last year and will approximate $125 billion in 1985.

Prior to the exchange-rate program launched by the Group of Five on September 22, the trade-weighted exchange rate of the dollar was overvalued, relative to the underlying competitive position of the United States, by 30-35 percent. If that rate had continued, the current account deficit would have risen steadily to a level of about $300 billion by 1990 (comprising a merchandise deficit of $200 billion and net interest payments of $100 billion). The accumulation of deficits would by that time have produced a net international debtor position for the United States of about $1.3 trillion.[1]

The program launched on September 22, which seeks to correct the dollar misalignment, is thus of critical importance to the future of the US economy and to US trade policy. The initial results are encouraging: during its first week, the program produced an average correction of about 5 percent including a move of about 10 percent vis-a-vis the Japanese yen. The relative strengthening of the yen is particularly encouraging, as it is of course the most important currency for US trade purposes. Every percentage point strengthening of the yen against the dollar should ultimately reduce the US trade deficit with Japan by about $1 billion.[2]

The dollar has declined by about 10-15 percent from its peak overvaluation of 40 percent in late February. The correction began partly as a result of substantial European intervention in February-March, and resumed with the push given it on September 22. However, even with the recent decline, the dollar is only 2-4 percent below its average value in 1984.

Hence, contrary to assertions emanating recently from the Department of Commerce and some private forecasters, we are still on a path of steadily rising current account deficits which could

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1. About three quarters of the rise in the US trade deficit from 1980 to 1985, and all of the rise this year, can be attributed to the previous increase of 40-60 percent (depending on the index used) in the value of the dollar. The data are in Stephen Marris, Deficits and the Dollar: The World Economy at Risk (Washington: Institute for International Economics, forthcoming).

2. Details are in C. Fred Bergsten and William R. Cline, The United States-Japan Economic Problem (Washington: Institute for International Economics, forthcoming October 1985).

reach about $250 billion by 1990. The correction to date has taken about $50 billion off the prospective deficit at the end of the decade, but obviously leaves a long way to go.

To be sure, even the modest currency changes to date (if maintained) will limit the rate of future deterioration. However, given the time lags between exchange-rate and trade changes, the dollar's rise in 1984 will still be adversely affecting our balances in 1986. Indeed, even an adjustment of the full magnitude needed before year-end would mainly show up in 1987 and beyond. (It might even make the 1986 numbers worse due to the well known "J-curve" effect.) The decline in the monthly trade deficits in July and August, while obviously welcome, will almost certainly turn out to be temporary aberrants reflecting slower US economic growth and erratic movements in oil imports.

Next Steps

However, despite the lack of dramatic effects to date, I would applaud the effort to address the trade problem in the correct manner--by recognizing that dollar overvaluation is the core of the difficulty, and at least starting to address it seriously. All of us must be patient in awaiting the eventual trade results which, as just noted, take several quarters to appear because of the time lags involved. The key point is that adjustment action has finally been initiated.

But it is essential that the effort begun on September 22 be pursued vigorously over the coming weeks and months. The target should be a further correction of 25-30 percent in the trade-weighted dollar. Every percentage point adjustment of that rate can be expected to eventually improve our current account position by about $3 billion.

Substantial, coordinated and skillful intervention can continue to promote the needed changes. It is instructive that the yen, which normally moves much less (in both directions) against the dollar than the European currencies, has moved twice as much as they have since September 22. The reason is simple: Japanese intervention, running above $1 billion on some days, has been much heavier than European intervention.

There are skeptics who doubt that intervention by itself can have much lasting impact. However, there has clearly been a very large measure of speculative "bubble" in the currency market for some time. If the new program can foster a basic change in market psychology, and forcefully remind traders that the fundamentals have long pointed to a lower dollar, it can have a substantial effect.[3]

Most previous intervention strategies, moreover, have been very different from the current approach because they have tried to resist market trends, i.e., they have "leaned against the wind." By contrast, the current strategy "leans with the wind"

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3. It is also sometimes argued that intervention cannot succeed because the resources of central banks are much smaller than the amounts moving daily through the private markets. Intervention, however, seeks only to alter the margin between ex ante supply and ex ante demand for a currency. This margin may be somewhat larger than five or ten years ago, because of the larger volume of capital flows, but currency volatility has not increased much and the markets are quite balanced most of the time. Moreover, the resources of the United States for the current exercise are unlimited because it is selling dollars and can obviously command as many as needed to assure success.

in three senses: toward underlying trade equilibrium, in support of an intermediate market trend which began last February, and in support of a very short-run market move which began in the week prior to September 22.[4] (This distinction is much more important operationally than the usual intellectual distinction between sterilized and unsterilized intervention.) It thus seems that the current effort has a good chance to succeed, if pursued diligently and credibly.

The role of the United States will be critical to the success of the intervention strategy. The Administration made a major contribution to the initial gains from the effort by indicating publicly for the first time, indeed with great fanfare, that it wanted to see a dollar correction. It pledged active participation in the market operations, and has been judged so far to be doing so adequately. But any flagging of visible Fed participation, in conjunction with the other central banks, would be seen as a relapse to the previous US disinterest in exchange-rate configurations and would probably torpedo the entire exercise.

The second immediate step which could promote dollar realignment on the needed scale, in addition to intervention, would be further easing of monetary policy by the Federal Reserve. US interest rates declined by about four percentage points from late 1984 through mid-1985, and were an important factor in the corresponding fall in the exchange rate. Likewise,

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4. See C. Fred Bergsten, "The Case for Leaning with the Wind." Financial Times, October 24, 1984.

Britain's sharp hike in its interest rates in February helped promote the dollar's move. It is clear that changes in interest rate differentials have a substantial impact on the market, and that further US easing could promote the process.

Market expectations concerning the direction of US monetary policy seem already to have changed since September 22 as it is now widely believed that no increase in interest rates will be permitted. However, a further easing of monetary policy would seem called for on domestic as well as international grounds. The economy is soft and inflation is well under control. The financial markets, both domestic and foreign, remain fragile. The rapid recent growth of the money supply reflects a sharp decline in the velocity of money and ongoing institutional changes.

No one would want to risk severe inflationary pressures to correct the dollar, but that risk seems minimal at present. A falling dollar will always generate some inflationary pressure on the economy, and the inevitable dollar adjustment will in essence re-import some of the price pressure which we exported via the dollar's rise during 1980-84. But the very large realignment which is needed for trade reasons seems acceptable at the present time because any actual rise in the price level could be quite modest. Indeed, the 10-15 percent fall of the dollar from late February to July seemingly has had little or no impact on the inflation numbers.

For the longer run, sustainable correction of the US trade deficit requires a sustained reduction of the US budget deficit--preferably, a total elimination of its structural component. The dollar and the trade deficit can be reduced without cutting the budget deficit further, through techniques such as those noted here. But the reduced level of capital inflow which would result might then prompt "crowding out" in the financial markets once there was any sizable pickup in credit demand, pushing up interest rates and limiting economic expansion. Hence reducing the budget deficit must remain the priority objective of US economic policy, for trade as well as "purely domestic" reasons.

Likewise, lasting correction of the currency and trade problems requires more effective expansionary measures in other major countries, notably Japan and Germany. Both have been sharply cutting their budget deficits, thereby generating excess domestic savings which spill over into capital exports and a concurrent current account surplus. More vigorous economic expansion abroad, especially if promoted by supply-side tax cuts, will also contribute to the correction by improving profits there and attracting capital to come back from the dollar.

The Implications for Trade Policy

The huge and growing trade deficit is clearly the main source of the enormous pressure for major changes in US trade policy. The overvalued dollar is clearly the major source of the trade deficit. Hence the outcome of the September 22 program has significant implications for US trade policy.

It should be noted that the trade deficit and trade policy, as normally defined, are two very different phenomena. As indicated, the trade deficit is caused almost wholly by monetary and macroeconomic phenomena (the dollar, interest rates, US budget deficits, fiscal and monetary policies abroad, etc.).

Trade policy actions, such as pressure on other countries to further open their markets to our exports and consideration of new import controls here, are extremely important for individual industries and for the credibility of the trading system. However, even if they are eminently "successful," they will have relatively little impact on the trade deficit. For example, even a total elimination of all Japanese import barriers, intangible as well as overt, would probably expand US exports by no more than $5-10 billion--a large sum, definitely worth pursuing, but a modest component of our global deficit of $150 billion (and even our bilateral deficit of $50 million with Japan).[5] Indeed, new trade policy measures might not on balance reduce the trade deficit at all--they tend to push the exchange rate in the wrong direction, in reaction to the anticipated direct improvement in the trade accounts, and may thus foster their own offset.

Efforts to reduce the trade deficit should thus focus on encouraging, or in the case of the Congress even requiring, sustained and effective follow-through by the Administration on the dollar program announced on September 22. As indicated above, a further correction of 25-30 percent is required to restore equilibrium in our current account position. Substantial reductions in the budget deficit are needed to assure lasting success of the effort and a healthy US economy in its aftermath, as are complementary macroeconomic policy changes abroad. Achieving such results should be the centerpiece of all further trade action by the Administration and the Congress.

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5. Details are in C. Fred Bergsten and William R. Cline, The United States-Japan Economic Problem (Washington: Institute for International Economics, forthcoming October 1985).

Mr. Florio. Thank you very much. You have certainly given us a lot to absorb and to think about.

I recall, and correct me if I'm wrong, one of the other predictions that you offered to us the last time you were here was the expectation that at some point the dollar would plummet and that the withdrawing of capital from our market would cause great economic dislocations in this country.

Is that prediction still out there as a potential or is it that something else has occurred so as to make that prediction less accurate?

Mr. Bergsten. No; you are quite right, Mr. Chairman. I said at the time that if the United States itself failed to address the exchange rate problem in a constructive way——

Mr. Florio. Which we have not done.

Mr. Bergsten [continuing]. Which we have not done yet, at some point the rest of the world would become unwilling to continue putting the huge amounts of capital in here that were needed to finance our trade deficit. There could be a rapid withdrawal. The dollar could plummet, and this could push up inflation, push up interest rates and the like.

So far, thankfully, that has not happened. The prediction for a declining dollar did begin to take place early this year. After the dollar reached its peak at the end of February, it did turn around and begin to come off substantially. In fact, it came off, depending on your measure, between 10 and 15 percent, pushed by some European intervention but mainly through market forces, between the end of February and the middle of July. So an important correction was under way.

Fortunately, it was what I would characterize as a very soft landing for the dollar. It happened in an environment of lower interest rates, with inflation still under control. And I think the main reason why we did not get adverse effects, was in a sense paradoxical, that our own economy had slowed down quite a lot. The U.S. economy was soft, there was no upward pressure on inflation or interest rates, and so the dollar decline could occur without adverse effects.

Moreover, I think the main reason the dollar came off was that U.S. interest rates were reduced sharply during that period. When you said we hadn't come to grips with the problem yet, you are absolutely correct in terms of the budget problem. But because the domestic economy was slowing down substantially over these last 12 months, the Federal Reserve was able to ease monetary policy substantially from about the end of last year.

U.S. short-term interest rates declined by about 4 percentage points from late 1984 through the middle of 1985, and I think that was the major reason why the dollar did decline substantially in the first half of this year and why it occurred in a reasonably soft way. It was the United States taking an initiative through monetary policy—not governmental policy but through the Federal Reserve's monetary policy—and that, I think, led to this rather gentle decline which did not conjure up the adverse consequences that you mentioned.

A hard landing is still very possible. That, indeed, is one caution that the officials now have to have in mind as they carry out the new strategy and, hopefully, therefore, budget action and other fundamental action will be taken to round out the package.

Mr. **FLORIO**. Your suggestion that the strength of the dollar is the overriding cause of the trade deficit implies that we should do what it is we are trying to do to formulate a fair trade policy but that we shouldn't have any great expectation that in and of itself, greater access to overseas markets is going to change things.

I am particularly interested in your major emphasis on intervention as a means of dealing with the overvalued dollar, the buying and selling of currencies, and your thought that we may be more successful in having that do more rather than less in stabilizing the dollar because we are now leaning with the wind, as you say.

I am interested—and we have had these hearings in the last few days on telecommunications—I am interested in how that plays out when we see what has happened with telecommunications and the Japanese, that the trade deficit last year was $600 million, anticipated to be double that this year even though we are leaning with the wind, apparently, in stabilizing the dollar a bit, marginally.

Even though the Japanese allegedly have started to open their market, why isn't it that we are seeing a better result with regard to our trade deficit in that very productive part of our area if we are leaning with the wind, market access is occurring, there is a greater degree or a bit of a greater degree of stabilization, and yet the trade deficit in that area is still doubling off of what it was last year.

Mr. **BERGSTEN**. Well, as I mentioned, there is a real timing question. The correction of the yen-dollar exchange rate has really just begun in these last couple of weeks. The yen-dollar rate was quite stable, in the 240 to 250 range for most of the last year. That is a rate that adversely affects U.S. price competitiveness by at least 20, maybe 30, percent. So the numbers that you have in mind for U.S. trade this year are reflecting the exchange rate that existed over the past 1 to 2 years, depending on what the leadtime is on telecommunication orders to sales, and I don't know the answer to that.

As I mentioned, we won't begin to see big effects showing up in the trade numbers from this current exchange rate change until well into 1986 and maybe into 1987. So what you would have to do to test your thesis would be to make a projection after things settle down enough as to where telecommunications trade looked like it was headed over the next 2 to 3 years.

I would certainly hope to see a turnaround to the extent—and this is an important caveat—that trade in this particular sector reflects exchange rate changes. I cannot in all honesty tell you that, because there is a yen-dollar correction, we are going to see a gain for the United States trade balance with Japan in every sector.

I can tell you with some confidence that the aggregates are going to improve enormously, but within the aggregates there are always changes going on in competitive advantage, with one or another industry doing better or worse. If for some reason telecommunications is losing its competitiveness for broader reasons, it might not enjoy the full benefits of the exchange rate change.

If, however, we are confident that our telecommunications industry should be competitive on a global scale and if access is opening up, then I think this factor would be very important by some time into the second half of 1986 and in 1987.

Mr. **Florio**. The question, of course, that is raised is can we endure that length of time with the current problems?

Let me just touch on two points and then yield to the gentleman from New York. One is that, as I'm sure you know, not everyone subscribes to your view that intervention as such in stabilizing the dollar is really going to make that much difference, and certainly in the minds of some is not going to make that much difference over a long period of time, because the expectation is there will be an adjustment to the buying and selling. Rather what has to be done to ensure greater stability in currency ranges is to take actions to induce higher degrees of growth and development in some of our trading partners, as well as to deal with our own fiscal policies.

Again making reference to the telecommunications situation, the testimony was that the Japanese market is only $4 billion. They have half as many people as we do, and our telecommunications market is $60 billion or $80 billion. The only way you are going to have an impact is to induce the Japanese to change their policies internally so as not to save as much and rather to consume that much more, have a higher degree of growth, and that will build the market that will enable us to make any difference.

Do you think there is any validity to the idea that direct intervention is maybe overemphasized by some as a means of stabilizing the dollar on a permanent basis and that it's these types of fiscal and growth policy developments that we should be attempting to induce our trading partners to become involved with that will become the substantial modifying factor?

Mr. **Bergsten**. I fully subscribe to the view that our main trading partners, particularly those running large surpluses and with very low inflation rates, notably Japan, should be taking more expansionary domestic economic policy measures. I had a paragraph on that in my statement; to save time, I didn't go over it in my oral presentation.

But I do think that, as a lasting solution to this problem, we are going to have to see more expansionary measures in Japan, Germany, and a few other countries. In addition to simply getting more rapid growth in those economies, I think some structural change is also desirable. You hinted at that, promoting more active consumer demand patterns in Japan.

In a sense, the underlying cause of the Japanese surplus in their external transactions, their trade, is that they save too much and invest too little.

Mr. **Florio**. Wouldn't they respond that, well, you have got all those problems in your economy, you want us to have them in our economy. We don't want that, and we are very pleased with the way that we are operating? What is our leverage other than, as some would describe it, protectionist leverage, to induce them to start running bigger debts than they currently have to chance the spurring of inflationary spirals? How is it in their self-interest in a positive way—as opposed to just warding off protectionist legislation in the United States—how is it in their interest to change their national policies in the ways you are suggesting?

Mr. BERGSTEN. They certainly do answer that we ought to be saving more here and maybe spending less, particularly spending less through huge Government budget deficits. But I think rather than saying that our system is no good and they shouldn't have any of it, what they would call for—certainly what I would call for—is some convergence between the two.

We do have to put our fiscal house in order. All of you know that. It's a matter of getting it done, and that is increasingly urgent. But beyond the immediate threat of trade retaliation from here, Japan has got to join the world. Japan is one of the——

Mr. FLORIO. Why? They are successful as far as they are concerned, aren't they?

Mr. BERGSTEN. They are successful in a narrow and short-run sense, but as long as the rest of the world looks like increasingly ganging up on them to bar them access to markets, retaliate against their trade across the board, they are going to be increasingly vulnerable. If there is one thing that is deeply embedded in the Japanese psyche, it's a sense of vulnerability.

They are an island. They are dependent on the rest of the world. In fact, they once got into a war because they didn't quite understand that enough and other countries didn't quite respond the right way to their needs. They know that, and they don't want to be ostracized from the world. That is the biggest threat to them, and I think they understand that the pressure now building up requires important change of them.

How to do that seems no easier, and maybe it's even harder, than getting our budget deficit under control here. That is proving to be intractable. But both have to move because both, in a sense, have to join the world in the kind of world economy we have got, where not only they but we, to a large extent, are now dependent on what goes on outside our own borders. We have to conform more to international norms.

That is, I think, the basic reason why Japan must and will over time adopt some of the underlying proclivities that we have. But it is going to take time, and in the meanwhile, some of these more immediate things have to be done like more rapid economic growth there but also direct action on the exchange rate.

I just want to say one word about the skepticism about intervention. It is certainly true that, for long-run stability of these exchange rates, you have to get the underlying fundamentals in order, and I certainly tried to stress that. But it is also clear, at least to me, that there is a very high degree of speculative bubble, for lack of any better word, in the exchange market.

No one can explain—I certainly can't—why the yen-dollar rate was 240 10 days ago and 214 yesterday, and why it might be 195 10 days from now. There is no rational difference in the situation over those 10 days to 3 weeks that would explain why the exchange rate moved by 20 or 25 percent, which is to say there is a large amount of psychology and speculation in the market.

The only thing that has happened is that the United States Government for the first time indicated it wanted to see a correction of the dollar. There is also an assumption now that the Fed won't raise interest rates further, although not yet a market expectation it will reduce them and there is an expectation that the central banks will come in and burn the speculators if they try to push the dollar back up.

Now, those are changes that have occurred basically through a new statement of policy, through a revealed willingness to intervene to deal with the exchange rate in a direct way. Can it last forever? Who knows? Maybe it will push the rate down to a level that really in some sense reflects the underlying fundamentals more accurately. I wouldn't want to bet on that, and I would want to do more. But I think those who denigrate the possibilities of what has been done really do give short shrift to what we have seen in 10 days but also to some previous episodes that also support it.

Mr. **Florio**. Does the policy you have been advocating, if it is successful, cause us inflationary problems in that you are talking about intervening to bring the dollar down, a more active monetary policy, the net result being the reduction of the trade deficit, which, of course, reduces the anti-inflationary pressures that are there as a result of imports, so that if you are successful in the policy that you are advocating, we no longer have the inflationary counterbalancing pressure, and you are advocating those things which directly are inflationary, the pumping in of more money.

Are you at all concerned about that in terms of a loose monetary policy and then taking off the protection of imports in restraining price increases?

Mr. **Bergsten**. Any correction of the dollar exchange rate does generate inflationary pressure on the economy. That is tantamount to saying that if we want to correct our trade deficit, we have to run some risk of inflationary pressure. That is true, because as the dollar went up so sharply over the last 4 years, it did reduce the inflation rate. We essentially exported some of the inflationary pressure generated by our rapid recovery in 1983-84, and as the dollar goes back down, we do run a risk of reimporting some of those inflationary pressures.

I happen to regard that as inevitable because I don't think you could sustain the dollar at these overvalued levels even if you wanted to, and therefore it is not a matter of whether, it is when and how. I happen to think the present time, probably just by fortuitous coincidence, is a good time to make this effort because the underlying economy is soft. The inflation numbers themselves are very modest—indeed, in the last month the producer price index was actually negative.

So as you get inflationary pressure from a declining dollar, you might not get very much actual inflation, given the softness of the economy and the low inflation numbers.

The intervention effort itself need not have any inflationary impact because the pumping of dollars into the market to buy foreign currencies can and is sterilized by the Federal Reserve through its open market operation. They do not produce any net change in M1, M3, the money base, any variable you want. Standard practice is to sterilize the monetary effect of the intervention itself.

Mr. **Florio**. You are advocating to supplement that by a looser monetary policy.

Mr. BERGSTEN. As I said, I would advocate lower interest rates now for a variety of domestic and dollar support reasons, and I don't think that would run any risk of significant inflation because the underlying economy is soft and inflation is under such control.

Mr. FLORIO. Thank you very much.

The gentleman from New York.

Mr. LENT. We just have a few minutes, so I will get off my chest what I have on it.

It seems that both you and Mr. Feketekuty, coming from entirely different directions, have both told us that this kind of legislation that we are actually having the hearing on, to eliminate trade barriers and so forth, even if passed, would only make a small dent in the overall trade deficit picture. I don't know whether you agree with him on other things or whether it is even important to establish that.

But your testimony was that three-quarters of the problem that we are facing vis-a-vis trade deficit has to do not with the legislation we are dealing with but with the strength of the dollar, the excessive strength of the dollar which puts this 30, 35 percent tax on exports and a 30-, 35-percent subsidy on imports.

My question is: Is what you are telling us that we will have to continue as a nation to intervene in the currency market as took place on September 22 over the longer run?

Mr. BERGSTEN. I'm not sure we will have to continue intervening. One of the reasons I have some hope for success in this operation is that once a change in policy of this type is adopted and intervention is shown to be taking place, the private markets may carry most of the correction. It's the old truism of banking: the more clearly you are willing to spend lots of money, the less you need to spend.

In fact, aside from the Japanese on a couple of days, there has not apparently been all that much intervention so far, yet the exchange rates have corrected already to an encouraging degree. So I am not sure at all it will have to keep up forever; it is maybe a matter of getting a one-shot change in psychology. The private bandwagons in the past have rolled pretty effectively once the direction changed, and that may occur this time as well.

Mr. LENT. This problem that you anticipated the last time you testified before the subcommittee of possibly foreign investors pulling out in great amounts their investments, isn't that more likely to occur as we devalue the dollar?

Mr. BERGSTEN. Yes. Once the rate begins moving down, one would see a lot of foreign dollar holders perhaps selling out in order to take their gains from the past 4 or 5 years' rise in the dollar. However, what apparently is also happening is that other foreigners are saying, well, the dollar at this cheaper price is a good buy, so they will come in and actually buy dollars. So far, though there has been a net decline in the dollar's value, the markets have been reasonably orderly, and reasonably two-sided. There has not been a plummeting or a hard landing to this point.

Now, one has to watch it like a hawk because you don't want to trigger an excessive move on the downside either, but so far that too seems to be going relatively smoothly.

Mr. LENT. What you are saying to us is that this fixation we have here in Congress toward passing some sort of trade legislation—we got the TRAC bill, we got the LICIT bill, we have the leadership bill, the administration is going to come down the pike with a bill, hopefully, whenever, in 2 weeks, 3 weeks—that when it is all said and done, it is not going to make that much difference; what really makes a difference is the devaluing of the dollar.

Mr. BERGSTEN. That is what makes a difference on the trade balance.

Mr. LENT. Three-quarters of the difference.

Mr. BERGSTEN. Yes. That is the big policy action that can be taken to deal with the trade balance. I want to be clear, I'm not denigrating in any way the importance of improving U.S. trade law and the conduct of U.S. trade policy to assure market access. I'm simply cautioning you not to think that by taking those steps, you are going to have much effect on the trade balance.

Mr. FLORIO. Would the gentleman yield just on that point? I think it has to be emphasized. You are talking about the big picture and the impact as a nation, but one can reduce the trade deficit substantially and still leave total industries at risk, many of them very important industries that a nation cannot exist without. So our effort to deal with trade reform and modifications in the law are extremely important and in some instances crucial to the well-being of key parts of our overall economy.

Mr. BERGSTEN. I fully agree with that, and I would even go one step further. I think it is critically important to maintain a reasonably open world trading system. I agree with what you said earlier. You can't do that unless trade is fair and the playing field is relatively level.

So I am all for steps that would reasonably deal with that problem even though it will not have much effect on the trade balance.

Mr. LENT. Thank you.

I have no further questions.

Mr. FLORIO. We have a vote at this point. What we will do is recess for approximately 10 minutes and resume with the questioning when we come back.

[Brief recess.]

Mr. FLORIO. The subcommittee will kindly come to order.

While we are waiting to see if—one of the Members wanted to come back. Mr. Ritter said he was going to try to come back. Let me just ask you a couple of questions.

I saw something in my notes that the chairman of the New York Federal Reserve, Mr. Corrigan, predicted that because of our growing trade deficit, the U.S. public and private debt to foreign creditors would reach a half-trillion dollars by 1990.

What are your thoughts on that?

Mr. BERGSTEN. Unfortunately, he is a piker. As I mentioned earlier, we have done projections that showed if the dollar stayed at the levels prior to this new program, the U.S. external debt position would have reached about a trillion dollars by the end of the decade; and what has happened so far doesn't change it all that much. So he has got the right direction. Unfortunately, it is even worse than he suggested.

Mr. **Florio**. I have heard some say that that is not a problem, that that is not something we should be concerned about, that as a matter of fact, it is needed so as to supplement our own lack of savings capability in our country, and that conceivably you could go for prolonged periods of time with no traumatic occurrence.

You maintained in your previous testimony here and reinforced again today that possibly someone could decide, for rational or irrational reasons, to pull out their capital, but equally possible would be, even in the face of economic concerns, someone may decide for purposes of stability and political stability that it's a good place to keep one's capital and therefore for prolonged periods of time all these things can work well: that we are getting foreign capital to retool if we were retooling, to deal with our deficit problems, we are having imports, restraining inflation so that we can have aggressive monetary policy so as to keep things moving a little bit.

The big part that I see in that gradual scenario not being accounted for is employment. It just seems to me that that gradual, nontraumatic scenario doesn't address the employment questions that we have, and at some point, if you are basically a consumer demand economy, which we have been, you have sufficiently reduced the capability of consuming such that you don't have a healthy economic picture.

Could we get your thoughts on that?

Mr. **Bergsten**. I share your view, Mr. Chairman. From a purely financial standpoint, I could not prove to you that the situation might not remain afloat for a few more years, at least. I don't think it would remain afloat for very long because, on the projections that we have done, the amount of money that would have to be coming in here from abroad each year to finance the trade deficit, which, as I said, would rise to $300 billion by the end of the decade, would represent something like one-half of all savings generated in the whole rest of the world outside the United States.

Mr. **Florio**. But if the rest of the world was not unhappy—I mean the Japanese don't appear to have any great interest in pumping up their own economy, isn't it conceivable that we could go forward for a long period of time? Others have made the policy decisions to trade off slower growth rates for, I assume, financial stability, or at least domestic stability in terms of inflation, although there are fairly high unemployment rates in Europe. If they don't appear to be feeling the need to change internal policy.

Mr. **Bergsten**. From a purely financial standpoint it is conceivable, although I must say I find it a little hard to imagine that half of all the savings generated in the rest of the world would come in here. Normally, most countries spend 90 to 95 percent of the savings they generate domestically. They don't put them abroad at all, let alone into any one currency like the dollar.

That ratio has risen to 10 to 15 percent in the last couple of years. That is already unprecedented. I find it hard to believe it could go as high as 50, which would be necessary if there were no correction, but I can't prove that. I would as a bottom line, though, agree with your proposition that it would be highly undesirable for the United States to see that situation evolve, even if it were sustainable, which I doubt. Even if it were sustainable, I think it would be highly undesirable.

Indeed, I don't think it could happen for the reason that you are seeing here in the Congress now. Because of the job effects and some broader effects of running a $150 billion trade deficit, you get enormous pressure to restrict trade in individual industries. If the trade deficit were $300 billion, you would get those pressures at least doubled.

I don't think it would turn out to be sustainable in terms of our internal politics even if it were sustainable in terms of the flow of foreign capital.

One other point. The situation you described as being conceivable for the long run is not unlike what happened to the United Kingdom over a period of 50 years or so. The British pound was essentially overvalued by big amounts for at least 50 years, and maybe more, and the financial sector in the United Kingdom did quite well and still is one of the most competitive and efficient in the world, but their manufacturing base disappeared.

Mr. **Florio**. Isn't that a troubling example because it happened? I mean you had this prolonged period of nonattention, to result in a gradual deterioration in the standard of living, massive dislocation in the industrial base, and it occurred. So conceivably, it could occur here—not to be partisan—but particularly when there isn't a lot of leadership coming out of high circles designed to point out the problem.

When we hear there are 8 million new jobs that have been created under these policies without saying which kind of jobs, and the 2 million jobs that have been lost are higher paying, higher productive jobs, if there is that blurring of the impact of the gradual deterioration and the long-term impact of our debtor nation status. Mass appreciation of what the consequences are that only comes if someone is willing to take leadership and use the pulpit that is available, without that it seems to me that the British example can be replicated here as well.

Mr. **Bergsten**. The British analogy holds with your example because in 1925, Winston Churchill, who was then Secretary of the Treasury in the United Kingdom, set the exchange rate, after the post-First World War experience with floating rates, at a level that was way too high, and priced Britain out. In a year they had a general strike, and the British manufacturing base eroded ever after.

The analogy is disturbing because they didn't do anything about it. That ought to be the warning. We should do something about it.

Mr. **Florio**. Thank you very much.

Mr. Ritter.

Mr. **Ritter**. Thank you for your excellent testimony. You have a way of making some very complex problems appear a little more simple, and that is a real skill around this place.

Some say that the reason the Japanese yen was 240, 250 was that somehow, in some way, and no one could ever put their finger on it, the Japanese managed to keep it that way purposely. Is it possible that ever since this change was made in our policy and the signals were put out there, as you say, that they have somehow managed to bring the value of the yen down?

Mr. **Bergsten**. It just happens that I have done a study of that topic and, in fact, been involved in it during my days in government, as well. There have been earlier periods, particularly back in the mid-1970's, when the Japanese did intervene very aggressively to keep the yen from rising. In fact, I happened to be the one that caught them at it in the mid-seventies, and when I came into the Treasury in 1977, we insisted that they stop, and they did, and that began the exchange rate correction of that time.

However, in this recent period there is no evidence that they have kept the yen weak, and I have looked under every nook and cranny I can find. If anything, to the contrary. They have intervened quite a lot in these last 4 or 5 years to keep the yen from weakening even further. They have kept their domestic interest rates a good bit higher than called for by their domestic circumstances to keep the yen from weakening further.

So, at least through all the devices that are normally thought of as possible ways to manipulate your exchange rate, they have tried to keep the yen from getting even weaker and causing more problems. I think in a sense, though, you are right. Now that for the first time they have been given a strong signal from the United States that we want to see a stronger yen, they had the wherewithal to push the yen up.

That is one reason I am confident that if the United States sticks with its new approach, the yen will continue to rise, and maybe a good bit of the problem with Japan, at least in the aggregate, will be worked out.

Mr. **Florio**. Will the gentleman yield on that point?

Mr. **Ritter**. Yes.

Mr. **Florio**. Is there any validity to the argument that the Japanese policy, which provides less opportunity for domestic capital to be invested, is inducing the flight of capital from the Japanese market and thereby undervaluing the yen. It's not direct intervention or nonintervention, but rather there is a policy designed not to promote domestic investment, and therefore domestic investment goes overseas, which has the same effect as intervention, and that the whole policy is justified by the conscious desire of the Japanese, by definition an exporting nation, to provide the incentive of the undervalued dollar to make its products that much more competitive in overseas markets?

Mr. **Bergsten**. It is a very good question. It goes to motivation. Certainly the big capital outflow from Japan that has depressed the yen against the dollar is due to that excess of savings over investment. However, in absolute terms, Japanese private investment has been quite strong for the last year or two.

They just came in with a second quarter growth rate at an annual rate of about 8 percent. That has been driven very heavily by private investment. Private investment has not been weak in Japan, and the overall growth rate has not been weak. As I said earlier, I would like to see it even stronger. It is lower than Japanese growth rates in earlier periods, but it is not a weak economy, and it's not weak with investment.

What has happened is not so much that investment there has been weak but that the Government budget deficit has been coming down substantially and thereby absorbing less of the excess private savings over private investment.

The Japanese would come back to that and say but our budget deficit is still 3 percent of GNP, we are still financing a bigger share of our budget deficit through the capital markets than any other OECD country, we have got a higher Government debt to GNP ratio than any country in the OECD, including the United States, and so we are quite prudently trying to reduce our budget deficit.

The economic effect, however, has been, as I say, whereas their budget deficit, which was running 5 to 6 percent of their GNP 5 years ago, soaked up the excess private savings, it now doesn't do so. That difference goes abroad and weakens the yen.

There is one other point to make that is relevant. The yen is not a weak currency. It has been weak against the dollar, but even before this recent move, the yen was at all-time record highs against the deutsche mark and the European currencies. The trade weighted average of the yen actually rose 10 percent over the last 3 years, so it has not been a weak currency in the aggregate.

Mr. **Ritter**. Excuse me. If the gentleman would yield back, that is a really fascinating point. There is a strong economy with an 8-percent growth rate that is the envy of the entire world. This is quarter upon quarter upon quarter of growth rate. The only time they have ever flagged is when the oil crisis hit in the early seventies. I mean you would expect it to be a very strong currency.

Mr. **Bergsten**. And it has been against everything but the dollar. There have been three tiers of world currency. Conceptualize it that way.

Mr. **Ritter**. Why?

Mr. **Bergsten**. Why has it not been strong against the dollar?

Mr. **Ritter**. Yes, and been strong against the deutsche mark. It it strong against the Swiss franc?

Mr. **Bergsten**. It has been strong against everything except the dollar. There have been three tiers of currencies. The dollar has been strong against everything for 4 years. The Continental European currencies have been weak against everything. The yen, and to some extent the pound sterling, have been in the middle, weak against the dollar but strong against Continental Europe. It has really been a three-tier exchange rate matrix.

The question of why the yen has been weak against the dollar is somewhat of a puzzle. I think it comes back to what we were just saying. The excess savings in Japan above what was being utilized domestically—had to go somewhere and it went abroad. Because of the high interest rates and the safe haven appeal of the dollar, it mainly went into the dollar, and that pushed the dollar up against the yen even though the yen was strong against everybody else.

In that sense, it comes back to being in large part a United States problem because of our high interest rates, stemming from our budget deficits and the like, but in part it's a Japanese problem because they have been unable or unwilling to utilize their domestic savings in domestic expenditure terms, and so the two biggest economies in the world have been moving in opposite directions.

In terms of budget deficits, ours has gone way up and theirs has come way down. In terms of savings, theirs is high and ours is low. You are on a collision course. That is what we are now seeing and why I suggested earlier that we have got to converge back toward each other to get any kind of lasting resolution of the problem.

Mr. **Ritter**. I have one brief question to end with. Why hasn't the Canadian dollar moved at all? Why hasn't it strengthened against the United States dollar? If you talk about ballooning trade deficits, that is a big one, and in fact, in percentage terms, it is growing bigger.

Mr. **Bergsten**. I think the simple answer is that the Canadian and United States economies are so integrated and there is such an absence of barriers, informal or formal, between our two countries, that Canadian money continues to be attracted by the United States dollar because of our higher interest rates. So we have not seen the correction there that one might have seen with some of the other economies.

Mr. **Ritter**. So there is a fairly substantial difference in interest rates at this point?

Mr. **Bergsten**. Oh, yes. There is still a substantial difference in favor of dollar interest rates over interest rates elsewhere in the world.

Mr. **Ritter**. In Canada?

Mr. **Bergsten**. I haven't looked at the Canadian interest rate structure lately, so I can't honestly tell you. I'm sure there is, in real terms. Canadian inflation has continued to be higher than ours.

Mr. **Ritter**. Thank you, Mr. Chairman.

Mr. **Florio**. Thank you very much.

Just to follow up briefly on the point Mr. Ritter highlighted, and you highlighted in response to Mr. Ritter's question, the relationship between the dollar and the yen versus all the other currencies. Are the Japanese attempting to make the market penetration in the European nations that they are attempting to make in this country?

Mr. **Bergsten**. The share of their exports to Europe is certainly smaller than their share of exports to us, but in most recent years, the growth of their exports to Europe has been faster than the growth of their exports here.

Mr. **Florio**. I suppose my question is whether the Japanese perception of the attractiveness of our market overall and their need to penetrate our market product-wise or capital-wise that that requires them to be more competitive in our market than perhaps in other markets exchange-rate-wise, which would—not to pursue a conspiratorial theory—but might work toward the goal of attempting to take actions so as to get that extra added incentive that comes from the currency imbalance.

Mr. **Bergsten**. Without being conspiratorial, I'm sure the Japanese are much more concerned about the exchange rate of the yen against the dollar than they are against the Europeans, for a variety of reasons, including financial flows. I would note an interesting phenomenon, though, that even though the overall Japanese surplus has risen very sharply over the last couple of years, it has not risen with the Europeans. That is consistent with the fact that their currency is not undervalued against the European currencies but is against the dollar.

They run a sizable surplus with Europe, but it hasn't grown much the last couple of years. In fact, I think it actually went down a little bit last year. It's still high. Europeans are unhappy with it. And I should add that the Europeans are quicker than we are to put import controls against particular sectors that are causing them internal problems. That also would blunt the Japanese export expansion in Europe and their surplus in Europe, and it would also blunt the effect of exchange rate changes.

I think that is a factor that has got to be kept in mind.

Mr. **Florio**. Then if we were concerned about exchange rate imbalances, as we are, it would seem to dictate that the Europeans have had some success in correcting those imbalances by being a little more aggressive in restricting access.

That would seem to say that if, as you indicate, that the currency imbalance is the most significant factor in our trade deficit situation, that maybe we ought to think about that as a tool to go along with direct intervention, to go along with persuasive efforts to get other economies to have higher growth rates, that maybe the actions to restrict access are not just designed to provide the level playing field for equal access, that it is a tool to induce greater currency balance, as well.

Is that correct?

Mr. **Bergsten**. I follow you but I am doubtful that European trade restrictions have been a factor in pushing the yen to a stronger level against the European currencies. If anything, one would expect the opposite because the European trade barriers, of course, would tend to reduce the Japanese export surplus that, everything else equal, would tend to push their currency in a weaker direction.

My suspicion, though I can't document this in detail, is that there's been a fair amount of European investment in yen assets, and capital flows from Europe into Japan, just like there have been from Japan into the United States. But I don't have a full rendition of that in mind and I'd like to look at it more carefully and give you some further thoughts on it.

Mr. **Florio**. If there are no further questions let us express our appreciation to you once again for your participation today. Thank you very much.

We are pleased now to have our last panel of distinguished witnesses us to give us their collective thoughts on the legislation. Mr. Jack Sheehan, the legislative director and assistant to the president of the United Steelworkers of America; Mr. Richard Brennan, executive director of the Coalition of International Trade Equity; and Mr. James Conner, chairman of the Trade Reform Action Coalition.

Gentlemen, we welcome you to our subcommittee. We would ask you to come to the witness table. Your statements will be made a part of the record, and you may proceed as you see fit. We would ask the witnesses to introduce their colleagues for the record, that they bring with them.

Mr. Sheehan, we would be pleased to hear from you.

Mr. **Sheehan**. Mr. Chairman, because Mr. Brennan has some charts, he would like to appear first.

STATEMENTS OF RICHARD M. BRENNAN, EXECUTIVE DIRECTOR, COALITION FOR INTERNATIONAL TRADE EQUITY; JIM H. CONNER, CHAIRMAN, TRADE REFORM ACTION COALITION, ACCOMPANIED BY BRIAN TURNER, DIRECTOR, LEGISLATION AND ECONOMIC POLICY, INDUSTRIAL UNION DEPARTMENT, AFL-CIO, AND LAIRD PATTERSON, GENERAL COUNSEL, BETHLEHEM STEEL; AND JOHN J. SHEEHAN, LEGISLATIVE DIRECTOR, UNITED STEELWORKERS OF AMERICA

Mr. BRENNAN. My name is Richard Brennan, I am the executive director of the Coalition for International Trade Equity, also known as CITE. CITE was formed in 1983 by a group of high technology companies concerned with the deterioration of the international trade system, and in particular, CITE is concerned with the international market distortions caused by the policies and practices of foreign governments such as foreign industrial targeting.

I might ad lib a comment here, sir, listening to this interesting colloquy this morning, there's almost the implication that those of us who are concerned with trade law reform are here because of the trade deficit. I know many of us have been seeking trade law reform for many, many years.

Outstanding companies such as United Technologies, Du Pont, Monsanto, Motorola, the Harris Corp., Control Data, Olin, Westinghouse, and others are members of CITE. The complete list of CITE members is included in our detailed submission.

Mr. Chairman, they say a picture is worth 1,000 words; accordingly, I offer you 4,000 words. Time does not permit a detailed discussion of these four graphics; however, let me take a moment to describe them very briefly.

The first map depicts the world according to the theory of free trade. The second map we believe is a more accurate portrayal of international trading realities, depicting various degrees of Government intervention. The third graphic lists the specific market distorting practices of the major trading nations of the world. The fourth grahic shows 10 years of U.S. trade law enforcement, and less than 25 percent of almost 1,000 cases received direct import relief during that period.

I'd be happy to go into these later if you like.

But these graphics do help to set the stage for our discussion and provide an insight into CITE's concerns. One of CITE's primary concerns is addressed in title IV of H.R. 1950, relief from injurious foreign industrial targeting. We will confine our testimony to this title.

At one point in time, there were those in the U.S. Government who did not believe foreign industrial targeting existed. We should be well beyond that stage now. The existence of targeting is well documented. Certainly the Houdaille machine tool case demonstrated Japanese targeting, as did the detailed SIA analysis of the Japanese practices in semiconductors. However, the most detailed and thorough analyses of targeting were conducted by the U.S. Government itself.

The most extensive of these was undertaken by the International Trade Commission. The ITC studies of foreign industrial targeting started in April of 1983 and their third and final volume was completed in January 1985.

The ITC documented targeting practices of Japan, European countries, Korea, Brazil, Taiwan, Mexico, and Canada. In mid-1985, the USTR and the Departments of Labor and Commerce submitted to the Congress additional detailed documentation of foreign industrial targeting practices of other nations.

Included in our detailed submission is an analysis of over 40 studies recently completed by governmental agencies, industry, labor, and universities. Extensive government involvement in the business process and foreign industrial targeting are both very well documented in these studies.

We should ask ourselves: Are current U.S. trade laws adequate in dealing with foreign industrial targeting. The answer is no. The source of the answer is, again, agencies of the U.S. Government. The ITC, in its first, very thorough volume covering Japan, included an analysis of the adequacy of our current trade laws to address the problem of foreign industrial targeting. In summary, they found our laws to be wanting; however, the ITC indicated that most of the shortcomings of U.S. trade laws would be overcome if changes to section 301 proposed by CITE were made. These CITE-proposed changes to 301 are, in essence, contained in H.R. 1950.

Further, the USTR in its excellent study submitted to Congress a few months ago, identified six aspects of targeting which are not covered by current U.S. trade law. They do not address GATT consistent home market protection; they do not offset the economic effects of targeting when they are separated from Government practices by time; they do not counter the multiplier effect that arises because commercial banks and others might give a targeted industry preferential terms; they do not fully offset the effect of targeting of third country markets; they do not counter the entire benefit associated with unfair R&D assistance; and finally, they do not address cooperation among private firms which enhances their competitiveness.

These shortcomings in U.S. law submitted by the USTR cover the essence of the success of targeting, as well as the insidious nature of targeting.

From our vantage point, the USTR is probably technically, legalistically correct but very unresponsive to a problem well documented by the Government itself. A further frustration is that USTR did not recommend any significant changes in U.S. trade laws, but rather recommended further study.

We cannot wait for yet another study. These trade-distorting practices of other nations will continue to proliferate unless the United States in its leadership role does something about it. The United States must demonstrate that it will no longer tolerate these market distortions.

The problem of Government-caused market distortions is a structural one. It has been evolving over the last few decades. It has caused market distortions when the dollar was undervalued; it will cause market distortions when currencies become more properly aligned.

As other nations experience massive trade deficits, we are witnessing rather normal, natural reactions by Americans to strike back with tariffs and quotas, to limit imports into the United States or to gain access to foreign markets. We empathasize with these reactions; however, they are basically transitory.

CITE believes there is a need for a fundamental reform of our trade laws that will provide the United States with a generic response to these unfair trade practices. The United States must be in a position to respond to any unfair market distorting trade practice, both swiftly and effectively. We believe the proposed changes to section 301 will go a long way toward achieving this objective.

We would like to differ with Mr. Guarini's support of a Presidential veto in section 301 being added. We believe such explicit Presidential veto power would remove the value of the proposed changes to section 301. As Mr. Guarini indicated in his colloquy with you, the President has implicit veto power.

Finally, CITE does urge passage of H.R. 1950 at the earliest possible time. We would suggest that in the deliberation of the subcommittee, consideration be given to expanding the definition of targeting so that there is no doubt that the legislative history and the intent of Congress is to respond to the specific shortcomings in our current laws as identified by the USTR, as well as to those trade-distorting practices included in our presentation.

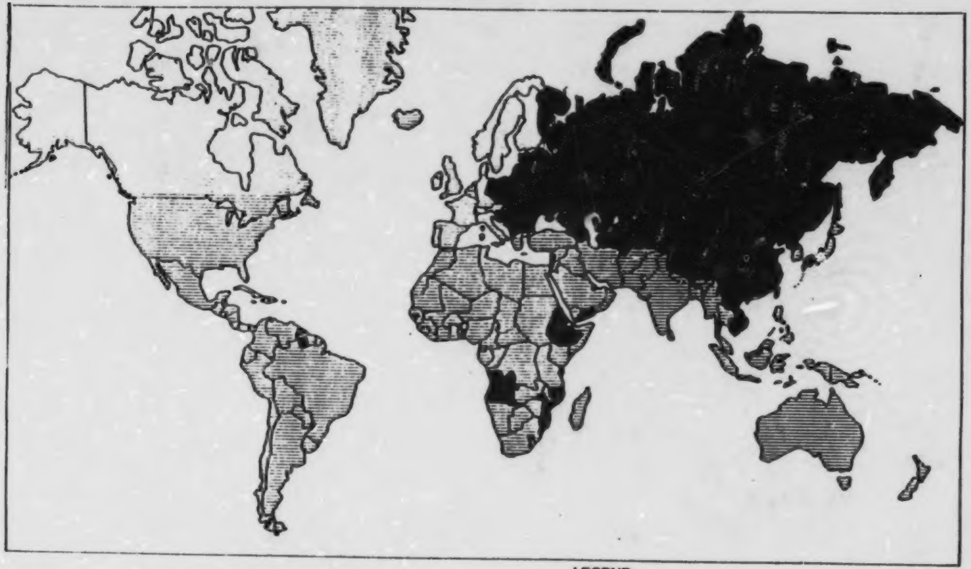
We look forward to continue working with you. Thank you.

[Testimony resumes on p. 563.]

[Attachments to the prepared statement of Mr. Brennan follow:]

COALITION FOR INTERNATIONAL TRADE EQUITY -- Oct. 3, 1985 ---- MAP #1

View of the World



LEGEND

▤ Free Trade Economies

■ Non-Market Economies

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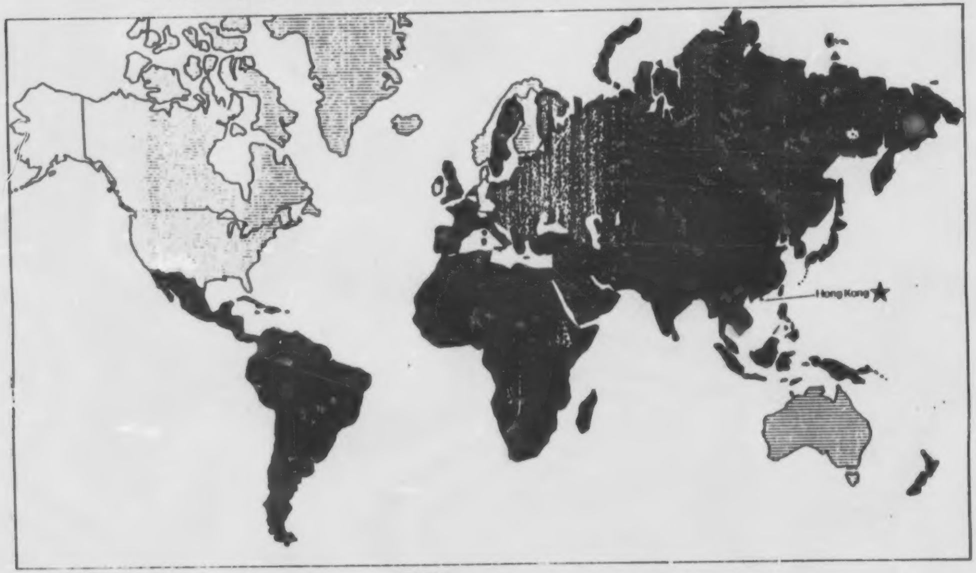
COALITION FOR INTERNATIONAL TRADE EQUITY -- Oct. 3, 1985 ---- MAP #2

Current International Trade Realities



LEGEND

Degree of Market Intervention by Governments

★ Minimal

▨ Moderate

■ Extensive

■ Non-Market Economies

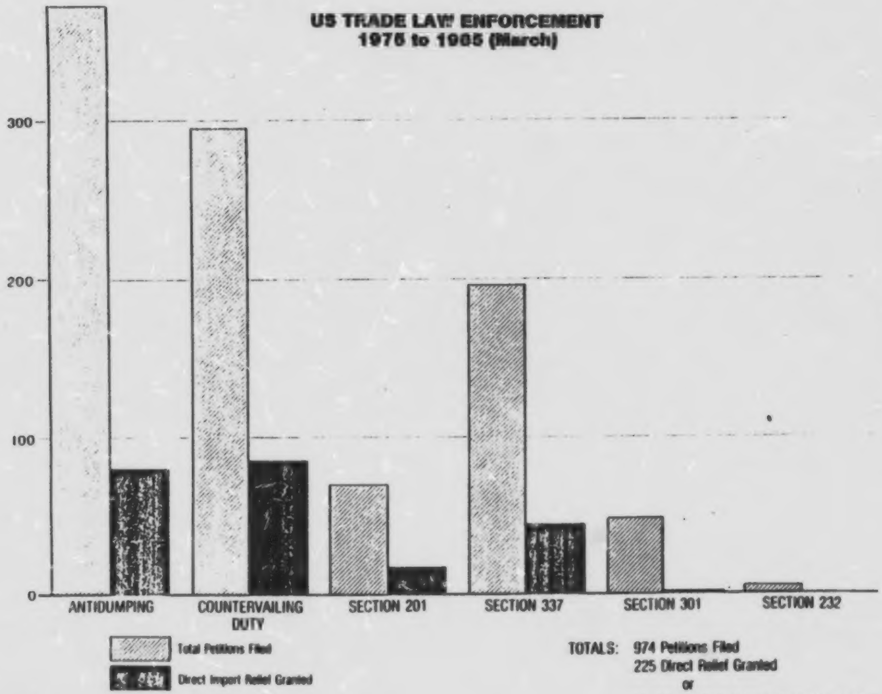
COALITION FOR INTERNATIONAL TRADE EQUITY -- Oct. 3, 1985 -- GRAPHIC #3

GOVERNMENT CREATED MARKET DISTORTIONS IN SELECTED COUNTRIES AS REPORTED IN RECENT STUDIES OF PAST AND PRESENT USES OF SUCH PRACTICES

GOVERNMENT CREATED MARKET DISTORTIONS	HONG KONG	US	EUROPEAN COMMUNITY	WEST GERMANY	UNITED KINGDOM	FRANCE	CANADA	JAPAN	SOUTH KOREA	BRAZIL	MEXICO	SINGAPORE	TAIWAN
Home Market Protection													
Tariffs		★	★	★	★	★	★	★	★	★	★		★
Quotas		★	★	★	★	★	★	★	★		★		★
Discriminatory Government Procurement		★			★	★	★	★	★	★	★		★
Other Non Tariff Barriers			★	★	★	★	★	★	★	★	★	★	★
Tax Policies													
Special Depreciation Rules				★	★	★	★	★	★	★	★	★	★
Exemption for Export Earnings								★	★	★		★	★
Tax Deferral for Export Earnings		★						★		★			★
Antitrust Exemptions													
Mergers			★	★		★		★	★				
Price Fixing Cartels			★	★				★					
Rationalization Cartels			★	★		★		★	★				★
Export Cartels				★				★					
Joint Research & Development		★				★		★					
Restrictions Against Competition			★					★					
Science & Technology Assistance													
Support for Research & Development			★	★	★	★	★	★	★	★		★	★
Control Over Technology Imports							★	★	★	★			★
Assistance in Acquiring Foreign Technology				★		★	★		★	★			★
Training				★	★	★	★	★	★	★		★	★
Financial Assistance													
Loans at Preferential Terms			★	★	★	★		★	★	★	★	★	★
Loan Guarantees			★	★	★			★	★	★	★		
Export Financing		★		★	★	★	★	★	★	★	★		★
Preferential Access to Investment Funds					★			★	★	★	★		
Preferential Access to Foreign Exchange			★					★	★	★	★		
Grants			★	★	★	★	★	★	★	★	★	★	
Foreign Investment Controls													
Restrictions (prohibition) on Investment in Certain Sectors							★	★	★	★	★		★
Export Performance Standards									★	★	★		★
Other Performance Standards (including Technology Sharing)							★	★	★	★	★	★	★
Government Ownership													
Nationalized Industries			★		★	★	★			★	★		★
Firms in Selected Industries State Owned			★	★	★	★	★	★	★	★	★	★	★

525

COALITION FOR INTERNATIONAL TRADE EQUITY -- Oct. 3, 1985 ---- GRAPHIC #4



US TRADE LAW ENFORCEMENT
1975 to 1985 (March)

TOTALS: 974 Petitions Filed
225 Direct Relief Granted
or
23.1% of Petitions Over Last Ten Years

COALITION FOR
INTERNATIONAL
TRADE
EQUITY

Submission to

COMMERCE, TRANSPORTATION, TOURISM SUBCOMMITTEE
HOUSE ENERGY AND COMMERCE

October 3, 1985
COMPLEMENTARY COMMENTARY and
SUPPORTING ATTACHMENTS

There is an urgent need for the US to develop an international trade policy that responds to the current economic realities.

The world trade problems facing our country -- the budget deficit, high interest rates, the overvalued dollar, the trade deficit -- currently are receiving much attention and discussion. But, there is an equally important international trade problem facing the country -- one that is not receiving the attention it deserves; namely, the increasing amount of international market distortions caused by foreign governments' policies or practices.

These market distorting practices have become so widespread that they represent a major structural change in the international economic system. We now are in the midst of this major economic shift, and unless the US government recognizes and responds to it, our country will be left behind in the backwash as this tidal wave of change continues to sweep over us.

It seems to those who believe in the traditional economic theories governing international trade, that the majority of countries endorse and engage in free trade. In this view, all goods and services move between nations of the free world according to the concepts of free trade and the principles of comparative advantage. As shown on the attached Map 1, the world is divided into two categories -- free market countries and non-market economies.

However, many of those engaged in international business believe that this view does not properly reflect the realities of international competition. The attached Map 2, depicts the various degrees of government intervention in the marketplace. The four levels:

- Minimal Intervention -- Hong Kong is the only one at this level
- Moderate Intervention -- There are 12 countries at this level, the US being one.
- Extensive Intervention -- All other free-market countries are at this level, including Japan and the European countries.
- Non-market Economies -- All the Communist nations.

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Thus, we see that no single nation totally adheres to the concept of free and open trade. Businesses involved in international trade know that free trade has become a myth -- a concept followed more in the exception than in practice. Foreign governments' direct involvement in international trade flows is becoming the rule. Closed markets, preferential financing, subsidies, condoned cartels, and preferential government procurement practices are now prevalent. Governments now control or own industries in the manufacturing and service areas. The attached Graphic 3 lists the specific market distorting practices of the major trading nations in the world. Of the 28 practices listed, Japan uses 25 while the US uses 6.

These economic realities will not change quickly -- this structural shift will not be easily changed. Over forty major studies, published in the last few years, analyze this structural change. The studies show that the market distorting practices of other nations are pervasive, even among the advanced nations of the world. A review of these studies (Attachment B) illustrates these trends and the agreement that government intervention has become a serious obstacle to American businesses.

The forty studies indicate that the trend in the world is toward the mercantilism of the 1930s, not toward freer trade. The Japanese "role model" is unfortunately being emulated by the emerging developing countries. Today, 140 countries have either extensive government involvement in the marketplace or are centrally-planned, non-market economies.

More importantly, what these studies don't show are the market distortions caused when a nation coordinates several of these intervention devices to benefit a selected domestic industry -- that is, industrial targeting. A corrollary to this is the virtually risk-free environment accorded the industry selected by its government to improve its competitiveness and the shift of increased risk to American manufacturers attempting to compete in that product sector.

Many of these practices are out of the purview of the GATT and current US trade law and thus, continue without any response either by the US or other nations.

The realities are quite clear: American businesses are competing against the full resources of governments. Many US trade laws are either inadequate or have not been used to respond to these distortions. Foreign government market distortions will continue to increase if left unchallenged.

The US must demonstrate, with a sense of urgency, its intolerance of foreign government intervention in international markets and flagrant violation of international and domestic trade laws. We must adopt a tough-minded approach of strong enforcement of our trade laws and -- where laws are inadequate -- new laws and policies, responsive to injurious practices, must be adopted. Graphic 4 shows the last ten years of US trade law enforcement -- less than 25 percent of almost 1,000 petitions brought have received direct import relief.

America must heed the urgent call for action. It must place the issue at the top of its agenda and seriously consider how best to formulate an American trade policy that will serve the nation well, while restoring order to the international trading system.

COALITION FOR INTERNATIONAL
TRADE EQUITY -- 10/3/85
DETAIL re: Graphic 4

US TRADE LAW ENFORCEMENT
1975 to 1985 (March)

Antidumping	Number	% of Total
Total petitions	372	100.0
Affirmative decisions	79	21.2
Negative decisions	132	35.5
Petitions withdrawn	69	18.5
Suspension agreements	3	0.8
Petition dismissed/ case terminated	31	8.3
Pending	58	15.6

Countervailing Duty	Number	% of Total
Total petitions	295	100.0
Affirmative decisions	84	28.5
Negative decisions	89	30.2
Petitions withdrawn	39	13.2
Suspension agreements	10	3.4
Petition dismissed/ case terminated	27	9.2
Countervailing duty order revoked or waived	17	5.8
Pending	29	9.8

201	Number	% of Total
Total petitions	64	100.0
Affirmative ITC decisions	34	53.1
Negative ITC decisions	25	39.1
President grants relief	17	26.6
President denies relief	17	26.6
Case terminated	3	4.7
Pending	2	3.1

(over)

337	Number	% of Total
Total petitions	195	100.0
No violation	39	20.0
Settlement agreements	35	17.9
License agreements	16	8.2
Consent orders	10	5.1
Cease and desist orders	5	2.6
Exclusion orders	39	20.0
Petitions withdrawn	1	0.5
Cases terminated	2	1.0
Pending	48	24.6

301	Number	% of Total
Total investigations	48	100.0
Relief granted	1	2.1
Negotiations to suspend unfair practice	47	97.9

Totals	Number	% of Total
Total petitions	974	100.0
Total relief granted	225	23.1
Total negative decisions	302	31.0
Total petitions withdrawn	109	11.2
Total petitions dismissed/ case terminated	63	6.5
Total pending	137	14.1
Total cases terminated based on agreements	121	12.4
Total countervailing duty orders revoked or waived	17	1.7

ATTACHMENT A

About CITE COALITION FOR INTERNATIONAL TRADE EQUITY

Trading tensions in the world are increasing and escalating in importance. CITE believes there is a need within the US to understand more fully some of the root causes of these changes in the world trading system and to recognize that other nations are not going to adopt our economic system. CITE believes US laws and the international trade regimen, such as the General Agreement on Tariffs and Trade (GATT), must be modified in such a way that permits these different economic systems to co-exist and accommodate (rather than confront) one another in order to keep international trade as open as possible.

CITE is a coalition of high-tech companies from a broad spectrum of industry who share a deep concern about the international trade environment. Based on its analyses and experiences in the international trade arena, CITE has concluded that the flow of international trade is governed less and less by market forces based on free competition and comparative advantage of one company versus another company.

Over the last decade, a major structural change has taken place in the international economic system. During this period, the direct (and indirect) involvement of governments in the business process has increased dramatically. This is true among the advanced nations of the Western world, the newly industrialized countries, and the developing countries.

This major change is significant because of the direct impact it has had on the way international business is now conducted. During the last decade, there has been a proliferation of trade distorting practices -- Orderly Marketing Agreements, Voluntary Export Restraints, the Multi-Fibre Agreement, exceptions to Most-Favored-Nation treatment, closed markets, subsidization, local content requirements, export performance requirements, targeted industry programs, import quota systems, import licensing systems, government procurement practices, etc. This litany of trade distorting practices can be applied to virtually every nation in the world; the US is no exception. Many of these practices are outside the surveillance or jurisdiction of any international framework or agreement such as the GATT.

The members of CITE are concerned with these trends and developments, particularly since such trade distorting practices may well become more prevalent in the decade ahead.

CITE's member corporations include: Control Data, Corning Glass, DuPont, GTE, Harris, Leading Edge Products, Monsanto, Motorola, Olin, Timex, United Technologies and Westinghouse.

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ATTACHMENT B

REVIEW OF RECENT EVIDENCE OF GROWING USE OF TRADE DISTORTIONS BY GOVERNMENTS

Prepared at the request of the

COALITION FOR INTERNATIONAL TRADE EQUITY

by

Harry Lamar

Montichello Associates

REVIEW OF RECENT EVIDENCE OF GROWING USE OF TRADE DISTORTIONS BY GOVERNMENTS

> "The world has changed greatly, and is now a world of planned economies, of state trading, of substantially arbitrary and inflexible structures and of managed instability in exchange rates. The classical theory (of international trade) is not directly relevant for such a world, and it may be that for such a world there is and can be no relevant general theory."[1]
>
> Jacob Viner, Economist
> 1951

> "If this (free trade) reasoning is correct, the industrial policies adopted by MITI (Japan's Ministry of International Trade and Investment) in the mid-1950's were wrong. Ironically, however, Japan's industrial policies achieved unprecendented success by going against modern economic theory."[2]
>
> Miyohei Shinohara, former head of
> the Japanese Planning Agency
> 1982

Introduction

These two quotes, made 30 years apart, accurately set the scene for this analysis. They also capture the dilemma of U.S. international trade policy. The first quote by Viner, a reknown advocate of free trade, bemoans the level of market distortions caused by governments in the immediate post-War period and questions whether the classical economic theory of free trade is at all relevant. Thirty years later, an influential Japanese government official, and an economic planning practitioner, informs us that Viner was correct, at least from Japan's point of view.

---

1. Jacob Viner, International Economics, Princeton University, The Free Press, Glencoe, Illinois, 1951, p. 16.

2. Miyohei Shinohara, Industrial Growth, Trade and Dynamic Patterns in the Japanese Economy, University of Tokyo Press, Tokyo, p.24

Thus, the question that this analysis addresses is the extent to which other countries have "gone against modern economic theory".

The massive trade deficits being experienced by the United States in recent years and the dramatic changes in the international competitive position of many of America's traditional and emerging high tech manufacturers have prompted a wide range of studies and analyses of this dramatic shift in the posture of the United States in world markets. They have been made by U.S. government agencies, leading universities, and a variety of other well-respected organizations in the private sector. As would be expected the studies contain a variety of conclusions about causes and recommendations as to what should be done.

The purpose of this analysis is to review these studies with a view to identifying "common threads", trends or developments regarding government-created market distortions to be found within these reports. There has been no effort to pass judgement on the conclusions and recommendations contained in each report.

In essence, it appears that Viner's observations of over 30 years ago was and is correct. In an almost "deja vu" reading, the various authors find that world trading conditions are in a state of disarray with the role of government vastly increased. These studies tend to underline Viner's rather prophetic conclusion regarding the irrelevance of free trade theory to today's trading system.

Since the period of which Viner spoke and now, the thirty intervening years, the United States has taken a leadership role in organizing six major multilateral trade negotiations, seeking to reduce barriers to trade mostly by agreeing to the lowering of tariffs through successive exchanges of tariff concessions. In spite of these efforts to develop a truly open multilateral trading system, with increased attention in the last decade to the elimination of nontariff barriers to trade, new market distorting practices are utilized.

Today, policy pronouncements from government officials around the world speak glowingly of the bene[illegible] free trade while their nations' actions are often quite the opposite. However, such professions of free trade philosophy cannot disguise the fact that there is growing government intervention in international trade. Many countries decry "protectionist" sentiment in the United States against imports made competitive by government trade distortions.

The Evidence

Of the forty studies reviewed about half were specifically directed at analyzing international market distortions caused by governments in particular countries. They reveal definite, disquieting patterns and trends. (See bibliography attached).

One of the most disturbing trends evident in the review is that since the successful approach of "going against modern economic theory", Japan has become a role model for other countries, particularly for the newly industrializing developing countries. This trend is disquieting in that adoption of this particular role model requires using trade practices which are often and increasingly outside of the traditional, accepted international trading disciplines set forth in the General Agreement on Tariffs and Trade (GATT), or, just as important, not specifically anticipated by U.S. trade law.

Table 1 illustrates the pervasive nature that government- created trade distortions have assumed as reported in recent studies of past and present uses of such practices. The countries used in the analysis account for approximately 60 percent of total world exports.

TABLE 1.

GOVERNMENT CREATED MARKET DISTORTIONS IN SELECTED COUNTRIES AS REPORTED IN RECENT STUDIES OF PAST AND PRESENT USES OF SUCH PRACTICES

GOVERNMENT CREATED MARKET DISTORTIONS	HONG KONG	U.S.	EUROPEAN COMMUNITY	WEST GERMANY	UNITED KINGDOM	FRANCE	CANADA	JAPAN	SOUTH KOREA	BRAZIL	MEXICO	SINGAPORE	TAIWAN
Home Market Protection: Tariffs		★	★	★	★	★	★	★	★	★	★		★
Quotas		★	★	★	★	★	★	★	★		★		★
Discriminatory Government Procurement		★			★	★	★	★	★	★	★		★
Other Non-Tariff Barriers			★	★	★	★	★	★	★	★	★	★	★
Tax Policies: Special Depreciation Rules				★	★	★	★	★	★	★	★	★	★
Exemption for Export Earnings								★	★	★		★	★
Tax Deferral for Export Earnings		★						★		★			★
Antitrust Exemptions: Mergers			★	★		★		★	★				
Price Fixing Cartels			★	★				★					
Rationalization Cartels			★	★		★		★	★				★
Export Cartels				★				★					
Joint Research & Development		★				★		★					
Restrictions Against Competition			★					★					
Science & Technology Assistance: Support for Research & Development			★	★	★	★	★	★	★	★		★	★
Control Over Technology Imports							★	★	★	★			★
Assistance in Acquiring Foreign Technology				★		★	★		★	★			★
Training				★	★	★	★	★	★	★		★	★
Financial Assistance: Loans at Preferential Terms			★	★	★	★		★	★	★	★	★	★
Loan Guarantees			★	★	★			★	★	★	★		
Export Financing		★		★	★	★	★	★	★	★	★		★
Preferential Access to Investment Funds					★			★	★	★	★		
Preferential Access to Foreign Exchange			★					★	★	★	★		
Grants			★	★	★	★	★	★	★	★	★	★	
Foreign Investment Controls: Restrictions (prohibition) on Investment in Certain Sectors							★	★	★	★	★		★
Export Performance Standards									★	★	★		★
Other Performance Standards (including Technology Sharing)							★	★	★	★	★	★	★
Government Ownership: Nationalized Industries			★		★	★	★			★	★		★
Firms in Selected Industries State-Owned			★	★	★	★	★	★	★	★	★	★	★

The government-created market distortions were categorized under the major headings of: home market protection; tax policies; antitrust exemptions, science and technology assistance; financial assistance; foreign investment controls; and government ownership.

Table 1. indicates for each of the countries whether the various types of trade distortions were reported in the studies analyzed. A listing of the studies utilized in this analysis is specifically noted in the attached bibliography.

In Western Europe the market distortions have been primarily in the area of protection for the home market, antitrust exemptions, financial assistance, and state owned enterprises. Canada appears to have concentrated in the areas of home market protection, foreign investment controls and government ownership. Not surprising, both because of its basic approach to the important role that foreign trade plays in its economic development, and because it has been studied more often, Japan has employed or is employing all of the government-created market distortions categorized and analyzed in this review.

What is disturbing is the extent to which the newly industrializing countries of Asia and Latin America are following the lead of Japan toward an export-led rapid development through the use of government-created market distortions, including home market protection, tax policies, science and technology assistance, financial assistance, foreign investment controls, and government ownership.

Brazil's documented practices, in particular, approaches Japan's status of market intervention, except in the area of antitrust exemption. It is to be noted on table 1 that while the United States employs some market distortions, they are not oriented toward creating an international market distortions, nor are they oriented toward creating an international competitive advantage for particular industries by a combination of government measures.

TABLE 2. HOME MARKET PROTECTION

GOVERNMENT CREATED MARKET DISTORTIONS	HONG KONG	U.S.	EUROPEAN COMMUNITY	WEST GERMANY	UNITED KINGDOM	FRANCE	CANADA	JAPAN	SOUTH KOREA	BRAZIL	MEXICO	SINGAPORE	TAIWAN
Home Market Protection Tariffs		●	●	●	●	●	●	●	●	●	●		●
Quotas		●	●	●	●	●	●	●	●		●		●
[illegible]		●			●	●	●	●	●	●	●		●
[illegible]			●	●	●	●	●	●	●	●	●	●	●

Home market protection

An analysis of government-created market distortions starts with home market protection. All but a handful of countries, Hongkong and Singapore being the exceptions, have and continue to use tariffs as a measure for affording protection to domestic industries. Although tariff levels of most industrial countries have been lowered to less than 10 percent by successive rounds of tariff negotiations, developing countries, as a rule, maintain much higher rates of duty on imports. For example, only five percent of Brazil's tariff rates are bound under the GATT. Taiwan has some rates of duty as high as 100 percent. As a practical matter all countries have sought to maintain higher rates of duties on those imports which compete with their most vulnerable domestic industries.

Widespread use of quotas or quantitative limitations in the immediate post World War II period has declined in general, but industrial countries, in effect, have resumed use of these home protection measures by negotiating voluntary restraint agreements to protect import vulnerable industries. Developing countries simply refuse import licensing or foreign exchange to bar imports or limit the quantity. Such practices are still used by Taiwan, Mexico, and Brazil, for example. Japan for many years had a very sophisticated licensing system, automatically granting import licenses only for needed imports. Licenses for all other imports were subject to strict review, often with administrative guidance from the Japanese government pointing out the desirability of purchasing in the home market.

In imposing a variety of nontariff measures to protect the home market, both Korea and Mexico, as well as other developing countries, have followed a policy of import substitution to promote industrial development.

Discriminatory government procurement is engaged in by almost all countries. Some, however, like Brazil have used it as an active measure to encourage fast development of it own industry. The Brazilian small commercial aircraft are a case in point. The policy of Nippon Telephone and Telegraph (NTT) of simply refusing to even consider purchasing foreign communications equipment is a leading example of how home market protection dies hard, even when the practice is the subject of international obligations, has been well documented, and plays an essential role in bilateral trade relations.

There are a variety of other nontariff measures which protect the home market industry. A number of countries like Brazil rebate all import taxes to favored industries. Mexico controls exports of many raw materials and semi-finished materials to assure an adequate supply for domestic consumption and/or to encourage export of finished goods.

TABLE 3. TAX POLICIES

GOVERNMENT CREATED MARKET DISTORTIONS	HONG KONG	US	EUROPEAN COMMUNITY	WEST GERMANY	UNITED KINGDOM	FRANCE	CANADA	JAPAN	SOUTH KOREA	BRAZIL	MEXICO	SINGAPORE	TAIWAN
Tax Policies Special Depreciation Rules				●	●	●	●	●	●	●	●	●	●
Exemptions on Export Earnings								●	●	●		●	●
Tax Deferral on Export Earnings		●						●		●			●

Tax policies

In terms of tax policies countries have long had special rules to foster development of particular industries or to provide incentives to export, including special depreciation rules, exemption of export earnings from tax or providing a tax deferral on export earnings. The latter is, of course, a well known U.S. practice in the DISC, found illegal by a GATT panel and finally replaced by a less effective FISC.

Japan has used tax policy to encourage industrial development overall and, in particular industries, to foster exports. Accelerated depreciation to encourage exports has been employed, and presently tax credits designed to encourage private sector research and development are provided. Tax-free reserves have been used to aid overseas market development and to foster overseas investment. In Brazil, tax incentives and disincentives are used to encourage exports and promote the production and sales of domestically produced goods. Such tax incentives include the rebating of income taxes on approved export sales, and the accelerated depreciation only for capital goods produced in Brazil. These and other tax programs are used generally to promote domestic production and export, and some apply only to selected industries.

In general, tax laws in West Germany, France and the United Kingdom apply equally to all industries. There are some exceptions with respect to distressed industries.

TABLE 4. ANTITRUST EXEMPTIONS

GOVERNMENT CREATED MARKET DISTORTIONS	HONG KONG	US	EUROPEAN COMMUNITY	WEST GERMANY	UNITED KINGDOM	FRANCE	CANADA	JAPAN	SOUTH KOREA	BRAZIL	MEXICO	SINGAPORE	TAIWAN
Antitrust Exemptions: Mergers			★	★		★		★	★				
Price Fixing Cartels			★	★				★					
Rationalization Cartels			★	★		★		★	★				★
Export Cartels				★				★					
Joint Research & Development		★				★		★					
[illegible]			★					★					

Antitrust exemptions

Antitrust legislation is a cornerstone of any free market system. However, cartels and cartel-like arrangements are subject to wide variety of limitations under the antitrust laws of various countries. Nevertheless, when governments provide an exemption from measures prohibiting anticompetitive behavior, trade is distorted to the extent that such exemption creates a competitive advantage that would not otherwise exist.

As noted in table 4, the Japanese Government has permitted the use of all types of cartels listed, price fixing cartels, rationalization cartels, export cartels, and cartels to permit joint research and development. In the interest of efficiency MITI has encouraged mergers in specific industries to establish larger and more efficient firms.

The European Community and member states have had a less rigid merger policy than the United States, but generally speaking do not favor price fixing and export cartels. However, there have been some exception to the general policy in the case of specific industries such as the wide range of merger, price fixing and reduction in competition measures permitted under the Community's steel policy.

TABLE 5. SCIENCE & TECHNOLOGY ASSISTANCE

GOVERNMENT CREATED MARKET DISTORTIONS	HONG KONG	US	EUROPEAN COMMUNITY	WEST GERMANY	UNITED KINGDOM	FRANCE	CANADA	JAPAN	SOUTH KOREA	BRAZIL	MEXICO	SINGAPORE	TAIWAN
Science & Technology Assistance: Support for Research & Development			●	●	●	●	●	●	●	●		●	●
Control Over Technology Imports							●	●	●	●			●
Assistance in Acquiring Foreign Technology				●		●	●		●	●			●
Training				●	●	●	●	●	●	●		●	●

Science and technology assistance

Increasingly governments have employed a variety of measures involving science and technology to encourage development and provide their industries with a competitive advantage in world markets. These include financial assistance through government conducted research, and direct and indirect funding as well as low-interest or below market rate loans. Other means of using science and technology for selected industries is by controling imports of technology. For example, Japan controlled imports of technology so tightly that many American firms "bought" access to the Japanese market by agreeing to license key technologies. In the telecommunications industry the Korean Government requires that foreign companies accept local partners for a 33-year ownership. The foreign company must also allow them to service and eventually manufacture their equipment under license.

TABLE 6. FINANCIAL ASSISTANCE

GOVERNMENT CREATED MARKET DISTORTIONS	HONG KONG	US	EUROPEAN COMMUNITY	WEST GERMANY	UNITED KINGDOM	FRANCE	CANADA	JAPAN	SOUTH KOREA	BRAZIL	MEXICO	SINGAPORE	TAIWAN
Financial Assistance Loans at Preferential Terms			*	*	*	*		*	*	*	*	*	*
Loan Guarantees			*	*	*			*	*	*	*		
Export Financing		*		*	*	*	*	*	*	*	*		*
Preferential Access to [illegible] Funds					*			*	*	*	*		
Preferential Access to Foreign Exchange			*					*	*	*	*		
Grants			*	*	*	*	*	*	*	*	*	*	

Financial assistance

Many governments provide low-interest loans and loan guarantees in one form or another to the private sector. However, some governments direct such funding at particular industries and to specific activities such as exports. For example, the United Kingdom provides loans to encourage mergers, many in the automotive and computer industries, because it was felt that the many firms were too small to compete internationally. Substantial grants have been made to the private sector steel industry in the United Kingdom to make payments to discharged workers and provide assistance in the closing or restructuring of plants.

Export credit assistance is extended by almost every government. Credit terms have become very competitive from time to time. Many lengthy negotiating sessions in the OECD and elsewhere have met with only limited success in discouraging uneconomic competition in this highly visible area of servicing export markets.

The real significance of financial assistance by governments is the extent to which they combine such assistance with other programs to encourage production and growth beyond the normal resource availability of the particular industry.

TABLE 7. FOREIGN INVESTMENT CONTROLS

GOVERNMENT CREATED MARKET DISTORTIONS	HONG KONG	US	EUROPEAN COMMUNITY	WEST GERMANY	UNITED KINGDOM	FRANCE	CANADA	JAPAN	SOUTH KOREA	BRAZIL	MEXICO	SINGAPORE	TAIWAN
Foreign Investment Control: Restrictions / prohibitions on investment in Certain Sectors							*	*	*	*	*		*
Export Performance Standards									*	*	*		*
Other Performance Standards including Technology Sharing							*	*	*	*	*	*	*

Foreign investment control

Foreign investment controls have been coupled more and more with performance requirements with respect to the amount of export sales, purchasing components domestically, or as mentioned previously, the requirement that technology be shared. Mexico generally requires Mexican equity participation in any foreign investment, and often foreign exchange availability is restricted on the basis of export sales. In some areas like natural resources no foreign investment is permitted.

TABLE 8. GOVERNMENT OWNERSHIP

GOVERNMENT CREATED MARKET DISTORTIONS	HONG KONG	US	EUROPEAN COMMUNITY	WEST GERMANY	UNITED KINGDOM	FRANCE	CANADA	JAPAN	SOUTH KOREA	BRAZIL	MEXICO	SINGAPORE	TAIWAN
Government Enterprises Nationalized Industries			*		*	*	*			*	*		*
Firms in Sectors Including State-Owned			*	*	*	*	*	*	*	*	*	*	*

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Government ownership

As indicated in table 8, some form of government ownership of selected industries is the rule, rather than the exception for most countries. From the ownership of all hydrocarbon resources in Mexico to NTT in Japan to the partial ownership of the computer industry in France and Brazil, governments use a combination of all of the above practices to enhance the competitive posture of government owned firms in their own domestic markets and in the export markets. For example, in Brazil the government reserved a part of the production and sale of computers for certain "national firms".

Government funds were used to set up a joint venture with foreign firms and, finally, a firm was established by the government which, using U.S. and British technology, became the first Brazilian computer manufacturer.

The government-created market distortions discussed above are now pervasive throughout the international trading system. Not only do governments have programs which encourage export-led development through the use of these measures in areas where their resources assure them of a comparative advantage, but they create their own comparative advantage in industries where the "natural and limited resources" of classical free trade theory would not provide them with the ability to compete.

As observed by Minister Shinohara:

> In general, the nurturing of infant industries is limited to a certain period of time and to a certain number of industries. In Japan, however, these measures were across-the-board and applied to almost all industries. This Japanese-type of infant industry may not be admissible from the generally accepted premises of international economics, for one of its fundamental concepts is international division of labor through free trade. Because of the vastly extended promotion of infant industries and across-the-board encouragement of exports MITI's approach ran counter to the basic principles of modern international economics.[1]

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[1] Shinohara, pp.24-25.

Note: Some of the practices described above by some of the countries have been discarded. Nevertheless, these practices played an active and significant role in the trade developments which took place at the time they were engaged in, and many observers think that their effects continue to be felt in world markets.

Foreign Industrial Targeting

Targeting begins when government measures are undertaken and directed at one industry with the planning aimed at an already existing market, usually the United States.

An example of how targeting works is the Japanese semiconductor industry. As indicated in one of the studies reviewed:

> In the late 1960's and early 1970's, the Japanese government protected its domestic semiconductor industry through import restraints and exclusion of foreign investment. It controlled the licensing of foreign technologies within Japan. The combination of policies was designed to keep the U.S. semiconductor industry from taking advantage of its technological leadership to establish a strong market position in Japan as it had in Europe and elsewhere. The Japanese government's effort permited domestic semiconductor producers to establish production capabilities and a strong domestic market position—laying the groundwork for the industry's rapid growth in the late 1970's.[1]"

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1. Semiconductor Industry Association (Prepared by Verner, Liipfert, Bernhard and McPherson, Chartered), The Effect of Targeting on World Semiconductor Competition: A Case History of Japanese Industrial Strategy and its Cost for America, Cupertino, CA, 1983, p. 1.

In another, more recent study of targeting and the semiconductor industry it was concluded:

> Because of Japanese restrictions on direct investment, the U.S. share of the Japanese market in the 1960's and 1970's likely was about half of what it would have been had American firms been able in that period to establish marketing and production facilities in Japan...
> In the U.S. market, the estimated range for loss of market share by U.S. semiconductor firms due to the combined effects of all Japanese targeting programs...ranges between 9 to 24 market share pointns or between 18 to 49 percent of the Japanese market position.[1]

Another example is the targeting of the Singapore computer industry by a combination of incentives as detailed in the same study.[2]

Government-created Market Distortions and the GATT

The evidence is overwhelming in industry after industry, from aircraft to telecommunications that government created market distortions have changed the competitive map of the world. Reacting to these and other developments, Arthur Dunkel, Director-General of the General Agreement on Tariffs and Trade commissioned a distinguished panel of seven to study and report on problems facing the international trading system. In March of 1985 the panel released the Dunkel Report. In that report is was observed that, "...the international trading rules of GATT are increasingly ignored or evaded."[3]

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1. Quick,Finan and Associates, An Analysis of the Effects of Targeting on the Competitiveness of the U.S. Semiconductor Industry, prepared for use by the Office of the U.S. Trade Representative, Washington, DC, June 1985, pp. iii and iv.

2. Ibid, p. 17.

3. General Agreement on Tariffs and Trade, Trade Policies for a Better Future: Proposals for action, A report to Director-General Arthur Dunkel, Geneva, March 1985, p. 5.

The studies and reports reviewed in this analysis corroborate that conclusion. Not only are some of the basic concepts of the GATT providing for nondiscrimination, equal treatment between domestic and imported goods observed only in the breach, but the provisions of the new codes of conduct agreed to in the Tokyo Round have remained ignored by many GATT members. Moreover, adherence to and disputes settlements under such new agreements as the standards code, the subsidies code and the government procurement code have fallen far short of adding strength to the international trading system.

What is disturbing as well is the many trade distorting practices that remain outside the GATT framework, but which have significant effects on trade flows and competitive impacts. Such practices as restrictions on foreign investment, accompanied by such performance requirements as export goals and sharing of technology. There appears to be great resistance to negotiating new rules in the GATT. Yet the need is obvious. In such areas as international services, intellectual property rights protection and agreements to enhance the free flow of information international rules of conduct are essential to any trading system which purports to be open and multilateral.

Exchange rates

There are some who still hold that in the long run these market distortions do not have any adverse effect on national or international markets and eventually are "wiped out" through exchange rate adjustments.

The competitive problems of the United States began at a time the dollar was overvalued, and they have continued to grow. The productive capacities of our trading partners are not going to go away should the dollar assume a more realistic value in the world currency markets.

Concluding Observations

After reviewing the forty recently published studies, the realization becomes apparent of how difficult it is to convey in writing the pervasiveness of the trade distorting practices of governments covered in these studies. They are not only being used more frequently, but they are truly distorting trade, employment and investment patterns in a significant way. For example, in a most recent study (June 1985) completed at the request of the Congress covering foreign industrial targeting in the semiconductor industry it is stated:

> The range of estimates for possible change in market position (of the U.S.) represents an estimated cumulative loss of sales between 1977-84 of about $300 million to $750 million and a reduction in employment in the US industry of between 6 to 14 percent.[1]

Most of the studies concentrate on analyzing the trade practices of the advanced nations of the world or the newly industrializing developing countries. The magnitude of the deterioration of the international trading system increases dramatically by taking into consideration the fact that virtually all of the developing countries of the world have economic systems in which the government plays a major role (this is not meant as a criticism but simply a statement of fact).

The current international economic realities are vastly different than that envisioned in the postwar period at the time the GATT was formed.

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[1] Quick, Finan and Associates, An Analysis of the Effects of Targeting on the Competiveness of the US Semiconductor Industry, prepared for use by the Office of the U.S. Trade Representative, Washington, DC. June 1985, p. iv.

One of the most significant differences is not only the increased role of governmental influence on economic patterns, but that there are simply a great many more nation states in the world today than there were in 1947.

Many Americans still strongly believe in private enterprise and that the market system is the best long term allocator of resources. Consequently, these trends and patterns of increased government involvement in the international economic system are becoming increasingly traumatic, particularly to American businessmen.

The U.S. government, in its role as leader of the free world, also is experiencing trauma. Its long standing principle of conducting trade policy based on the theory of free trade may well be outdated and out-of-tune with current realities. In reviewing these forty studies, this latter conclusion is almost inescapable.

It necessarily follows that there is a need for the United States to reexamine and revise its international economic policy and trade remedy laws. But, unless there is a major change in the thinking of and actions by our trade policy makers, the challenge of these increasing government interventions in world markets will never be met.

A revised American policy should be one that not only takes into consideration our own national interests, but also one that works to restore order to the international trading system.

oOo

BIBLIOGRAPHY

Bibliographic notes

This review is based primarily on the studies and reports listed in the annotated bibliography on governments' marketing-distoring practices prepared by the Coalition for International Trade Equity. Dated March 14, 1985. The bibliography is attached.

This review relies heavily on the three excellent reports on industrial targeting in particular countries by the U.S. International Trade Commission, and which were prepared at the request of the Subcommittee on Trade of the House Committee on Ways and Means. The categorization of governments' market-distorting measures developed in the preparation of these three reports appears to have become the standard for describing such practices in later studies of such government interventions.

It also must be noted that the description of governments' market-distorting measures in this review borrows extensively from the descriptions contained in these ITC reports.

In addition, some recently completed reports on targeting and other pertinent studies and reports have also been reviewed and utilized in this analysis. These are listed below:

U.S. International Trade Commission, Competitive Assessment of the U.S. Foundry Industry, Report to the President, Washington, DC September 1984. *

U.S. International Trade Commission, Potential Effects Foreign Government Policies of Pricing Natural Resources, Washington, DC, May 1985. *

U.S. International Trade Commission, Analysis of the International Competitiveness of the U.S.Shipbuilding and Repair Industries. Washington, DC, April 1985. *

Booz-Allen & Hamilton, The Effects of the Foreign Targeting on the U.S. Automotive Industry. Prepared for the Department of Labor and the Office of the U.S. Trade Representative, Washington, DC, May 1985. *

The Futures Group, Inc., The Impact of Foreign Practices on the U.S. Computer Industry. Completed under contract to the Office of the U.S. Trade Representative, the Department of Commerce, and the Department of Labor, Glassonbury, Connecticut, April 30, 1985.*

Quick, Finan and Associates, An Analysis of the Effects of Targeting on the Competitiveness of the U.S. Semiconductor Industry. Prepared for use by the Office of the U.S. Trade Representative, Washington, DC, June 1985. *

General Agreement on Tariffs and Trade, Trade Policies for a Better Future: Proposals for Action. A report to Director General Arthur Dunkel, Geneva, March 1985.

Senate Democratic Working Group on Trade Policy, *The New Global Economy : First Steps in a United States Trade Strategy*, Washington, DC, April 1985.

President's Commission on Industrial Competitiveness, *Global Competition: The New Reality*, Volumes I and II, Washington, DC, January 1985.

Harold B. Malmgren, *Changing Forms of World Competition and World Trade Rules*, CSIC, Georgetown University, Washington, DC, 1981.

Office of the U.S. Trade Representative. *Chairman's Report on a New Round of Multilateral Trade Negotiations*, Reports of advisory committees and private sector organizations submitted to the
United States Trade Representative, DC, May 1985.

* Indicates study or report used in table 1. of review

COALITION FOR INTERNATIONAL TRADE EQUITY
March 14, 1985

STUDIES/PAPERS ON GOVERNMENTS' MARKET-DISTORTING PRACTICES
(An Annotated Bibliography)

Australian Industrial Development Association (AIDA) -- WORLD TRADE DISTORTIONS: A STUDY IN MODERN TRADE PRACTICE -- 1983

describes the increasingly "managed" world trade practices, the intervention tools, some specific sector studies (agriculture, textiles, steel, autos, petrochemicals, services) and country surveys covering: Singapore, Korea, Brazil, New Zealand, United States, United Kingdom, France, Japan and Australia. *

Berkeley Roundtable on International Economies (BRIE) -- US AND JAPAN TRADE AND INDUSTRIAL POLICIES -- September 1984

discusses Japan's various policy tools (financing taxes, subsidies) as well as the policies; mentions that although US has an "industrial policy" through the Dept. of Defense, these do not directly benefit private sectors and still are not of the level of commercial programs in Japan.

Coalition for International Trade Equity (CITE) — REPORTS FROM THE CITE SURVEY: A COMPENDIUM OF THE ROLE OF GOVERNMENTS IN INTERNATIONAL TRADE — May-June 1984

one-page summaries of government involvement/intervention in the marketplace; countries covered: South Korea, Canada, Singapore, Taiwan, European Community, United Kingdom, West Germany, Italy, France, Brazil, Mexico, Japan, Hong Kong, US *

Commission of the European Community — THE EUROPEAN COMMUNITY & JAPAN June 1981

describes the EC/Japan relationship, trade problems, and alternatives for improving the strained relationship. Statistics include Japanese export levels to the EC and vice versa

Commission of the European Community — THE EUROPEAN COMMUNITY AND STATE AIDS TO INDUSTRY — May 1982

discusses theory of free trade within the EC and practice of discrimination among EC member states including state aid to industry sectors, regional development, research & development subsidization, energy and export promotion. *

Commission of the European Community — INDUSTRIAL POLICIES IN THE COMMUNITY: STATE INTERVENTION AND STRUCTURAL ADJUSTMENT -- January 1981

describes various state intervention tools and rationale behind them (regional development, restructuring of industry, international competitiveness). Also discusses EC reactions to these trade distortions. *

Congressional Budget Office — FEDERAL SUPPORT FOR R&D AND INNOVATION April 1984

discusses US government financing for private and public sector research and development through tax policies, antitrust laws, patent policy, procurement policies and suggestions for improving the support.

Congressional Budget Office — FEDERAL SUPPORT OF US BUSINESS — January 1984

discusses US government support of businesses through various policies including direct expenditures, credits, tax credits; although most of the US support is not granted to just a few sectors, the largest recipients tend to be manufacturing industries (ie, steel, autos).

Congressional Joint Economic Committee — POLICIES FOR INDUSTRIAL GROWTH IN A COMPETITIVE WORLD: A VOLUME OF ESSAYS -- April 1984

five essays, written by scholars at Overseas Development Council, cover the major issues of policies (investment, technology, trade, labor markets, and antitrust policies) used to promote industrial competitiveness -- both what US and foreign countries do to aid their industries.

Data Resources, Inc. -- DRI REPORT ON US MANUFACTURING INDUSTRIES — 1984

describes the decline in competitiveness of US manufacturing due to the overvalued dollar, tax laws and the industrial policies of foreign nations. Concludes with policy alternatives and scenarios for the future competitiveness of US manufacturing.

Europa Institute (University of Amsterdam) -- PROTECTIONISM AND THE EUROPEAN COMMUNITY — 1983

series of scholarly essays defining the EC common commercial policy (most-favored-nation status for member states), instruments available for import relief, specific protectionist actions against Japan, textile policy, and future trade negotiations agenda.

Japan-US Business Conference — UNDERSTANDING THE INDUSTRIAL POLICIES AND PRACTICES OF JAPAN AND US: A BUSINESS PERSPECTIVE --July 1984

a look at the industrial policies of Japan and the US from the other country's viewpoint, areas of conflict, effects on trade, and possible solutions.

Labor-Industry Coalition for International Trade (LICIT) -- INTERNATIONAL TRADE, INDUSTRIAL POLICIES AND THE FUTURE OF AMERICAN INDUSTRY — April 1983
describes various industrial policies of foreign government (France, West Germany, Japan, South Korea) that impact international trade and effect US competitiveness. Concludes with recommendations for an effective US policy response. *

National Planning Association (NPA) — CANADIAN INDUSTRIAL POLICY -- June 1982
discusses Canadian industrial policies from 1960s to the present, policy objectives, alternatives, bilateral relationships (US and Canada) and future trends.

National Planning Association (NPA) — CHANGING PATTERNS OF US INDUSTRIAL ACTIVITY AND COMPARATIVE ADVANTAGE -- 1983
discusses the erosion of US comparative advantage in high tech caused by foreign industrial policies/government influence in shoving their domestic industries into the competitive high tech sectors. Foreign countries discussed: Japan, West Germany, United Kingdom, France and Italy.

National Planning Association (NPA) -- TAXES, SUBSIDIES AND COMPETITION INTERNATIONALLY — January 1982
discusses tax and subsidy policies granted by governments (US, United Kingdom, West Germany, France, Japan and Canada) in their domestic industries: textiles, steel, autos, computers and pharmaceuticals. Includes discussion of effects these policies have on international trade.

National Planning Associaition (NPA) — US ECONOMIC POLICIES AFFECTING INDUSTRIAL TRADE — 1983
dicusses US tariff and non-tariff policies at pre- and post-Tokyo Round levels and compares the US level of protection with Japan, France, United Kingdom, West Germany, and Italy. In-depth discussion of DISC, OPIC, tariffs and other US policies.

Scott, Bruce (Harvard Business School) — AMERICAN COMPETITIVENESS: PROBLEMS, CAUSES AND IMPLICATIONS — February 1984
paper describes the changes in US competitiveness and lack of action by US policy makers to these changes (ie. the competitors have changed: no longer EC but South East Asian countries). *

Scott, Bruce (Harvard Business School) — NATIONAL STRATEGIES — February 1984
an in-depth look at how governments "create" comparative advantage by focusing policy-decisions on improving competitive position of select industries. Japan is the model country with brief overviews of strategies used by others.*

Sekiguchi, Sueo & Horiuchi, Toshiro — INDUSTRIAL POLICIES IN JAPAN — September 1984
. describes Japan's industrial "targeting" from the Japanese point of view; criticizes some of the Japanese programs and mentions that some of Japan's policies are controversial in Japan.

US Department of Commerce — A COMPETITIVENESS ASSESSMENT OF THE US PETROCHEMICAL INDUSTRY — August 1982
an overview of both US and world petrochemical industry and resultant gradual decline in US competitiveness as more energy-rich countries become technologically equal to the US through government intervention. Countries discussed: Saudi Arabia, Mexico, Canada, Japan, EC and France.

US General Accounting Office — INDUSTRIAL POLICY: JAPAN'S FLEXIBLE APPROACH and CASE STUDIES IN THE JAPAN EXPERIENCE — June & October 1982
describes the evolution of Japan's industrial policies and in-depth analyses of policies used in five industries: computers, robotics, aircraft, shipbuilding, textiles and how Japan keeps or makes these industries internationally competitive.

US General Accounting Office — INTERNATIONAL RESTRAINTS TO COMPETITIVENESS OF THE US HEAVY ELECTRICAL EQUIPMENT INDUSTRY — September 1983
discusses loss of US competitiveness in heavy electrical equipment industry due to buy-national policies in Europe & Japan, dumping of foreign large power transformers in US market, and US government policies which have created barriers to exports.

US International Trade Commission — CHANGES IN THE US TELECOMMUNICATIONS INDUSTRY AND THE IMPACT ON US TELECOMMUNICATIONS TRADE — June 1984
describes both the US and selected foreign (Canadian, Japanese, British, Swedish, West German, Italian, French and Dutch) telecommunications industries and markets, including a discussion of tariff and non-tariff barriers to trade. Also, detailed analysis of break-up of AT&T and benefits to foreign suppliers.

US International Trade Commission — COMPETITIVE ASSESSMENT OF US METALWORKING MACHINE TOOL INDUSTRY — September 1983
describes US industry and relation to international trade. Also discusses government involvement in machine tool industry: US, Japan, West Germany, Italy, United Kingdom, France, Spain, Taiwan, South Korea and non-market economies. Concludes with analysis of US market and future trends. *

US International Trade Commission — COMPETITIVE POSITION OF US PRODUCERS OF ROBOTICS IN DOMESTIC AND WORLD MARKETS — December 1983
discusses both the US and foreign robotics industries (West Germany, Japan, Norway, Sweden, United Kingdom, Taiwan, Finland, Canada, Switzerland, Austria, Belgium, Netherlands, and France). Also analyzes the US market for robots and an assessment of the US versus foreign firms. *

US International Trade Commission — FOREIGN INDUSTRIAL TARGETING AND ITS EFFECTS ON US INDUSTRIES: PHASE 1 JAPAN — October 1983
defines "targeting" and its general effects on US industries as well as the effectiveness of US trade laws. Second half is an overview of Japan's practices (tax, finance, research & development and antitrust) as well as specific policies in industry sectors (aircraft, aluminum, autos, computers, iron & steel, machine tools, semiconductors, telecommunications) and an assessment of these government interventions.*

US International Trade Commission — FOREIGN INDUSTRIAL TARGETING AND ITS EFFECTS ON US INDUSTRIES: PHASE 2 EUROPEAN COMMUNITY — April 1984
describes and assesses industrial policies and targeting (tax, home market protection, financing, research & development, cartel/mergerpolicies) of France, West Germany, and the United Kingdom as well as those of the EC as a whole. Specific practices in industry sectors are also discussed -- aircraft/aerospace, autos, coal, computers/telecommunications, heavy electrical equipment, machine tools, semiconductors, steel mill products, and textiles/apparel.*

US International Trade Commission — FOREIGN INDUSTRIAL TARGETING AND ITS EFFECTS ON US INDUSTRIES: PHASE 3 BRAZIL, CANADA, SOUTH KOREA MEXICO, AND TAIWAN — January 1985
describes and assesses the specific industrial policy/targeting practices (tax, home market protection, financing, cartel/merger) of the five subject countries. Profiles specific industry sectors -- aircraft/aerospace, apparel, data processing equipment, footwear, machine tools, natural gas, semiconductors, steel mill products, telecommunications apparatus and textiles.*

US International Trade Commission — PROBABLE IMPACT ON US PETROCHEMICAL INDUSTRY OF THE EXPANDING PETROCHEMICAL INDUSTRIES IN THE CONVENTIONAL ENERGY-RICH NATIONS — April 1983
historical overview of the US petrochemical industry and the policies/practices of governments in energy-rich countries: OPEC, Canada, Mexico, USSR, China; also describes future supply-demand scenarios and other possible effects including increased industry-government interaction.

US-Japan Advisory Committee — CHALLENGES AND OPPORTUNITIES IN US-JAPAN RELATIONS — September 1984
describes the political/economic relationship between US and Japan and the trade policies and government actions which have caused problems, including closed markets, procurement, standards code, exchange rate problems, energy problems and trade in services.

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outlines trade frictions between US and Japan (including industrial and service sector problems, high technology problems, intellectual property differences, and investment policies) and suggests solutions.

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describes Japan's attempt for the last 10 years to become a world competitor in the semiconductor industry. Policies explained: government-industry cooperation, financial assistance, export drives, market protection, procurement practices and the harm inflicted by these practices on the US industry and the flaunting by the Japanese of international rules (ie, the GATT). *

Verner, Liipfert, Bernhard, McPherson & Hand — STEEL AND STATE: GOVERNMENT INTERVENTION IN THE MARKET AND ITS EFFECT ON INTERNATIONAL TRADE IN STEEL (4 Volumes) — Prepared for Bethlehem Steel and US Steel — 1984
a four-part historical overview describing government intervention (market controls, financing, subsidies, export drives) in the steel industries of Japan, European Community and Developing Countries and effects these policies have on US and world steel markets. Also, discusses past US policy responses and the state of the US industry. *

<THE END>

COALITION FOR INTERNATIONAL TRADE EQUITY -- Oct. 3, 1985 -- ATTACHMENT C

INTERNATIONAL TRADE COMMISSION (ITC) REPORTS
INDUSTRIES TARGETED BY FOREIGN GOVERNMENTS

JAPAN -- October 1983

- Aircraft
- Aluminum
- Automobiles
- Computers
- Iron & Steel
- Machine Tools
- Semiconductors
- Telecommunications

EC -- April 1984

France:

- Aircraft & Aerospace
- Apparel
- Autos & Trucks
- Telecommunications
- Electronics
- Heavy Electrical Equipment
- Machine Tools
- Semiconductors
- Textiles

United Kingdom:

- Aircraft & Aerospace
- Automobiles
- Computers/Peripherals/Telecom
- Heavy Electrical Equipment
- Machine Tools
- Semiconductors

West Germany:

- Aircraft & Aerospace
- Autos
- Information Technologies
- Machine Tools
- Semiconductors

Italy:

- Apparel
- Autos

EC Policies:

- Coal
- Computers/Peripherals
- Machine Tools
- Steel
- Textiles

BRAZIL, CANADA, KOREA, MEXICO, TAIWAN -- Jan 1985

Brazil:

- Aerospace
- Autos
- Computers
- Heavy Electrical Equipment
- Footwear
- Pharmaceuticals
- Semiconductors
- Shipbuilding
- Steel
- Telecommunications
- Textiles & Apparel

Canada:

- Aerospace
- Autos
- Petroleum/Gas
- Telecommunications

Korea:

- Autos
- Computers
- Heavy Electrical Equipment
- Machine Tools
- Pharmaceuticals
- Shipbuilding
- Steel
- Textiles & Apparel

Mexico:

- Autos
- Computers
- Petroleum/Gas
- Pharmaceuticals
- Steel

Taiwan:

- Autos
- Electronics
- Machine Tools
- Petroleum/Gas
- Pharmaceuticals
- Shipbuilding
- Steel
- Textiles & Apparel

Mr. FLORIO. Thank you very much. Mr. Conner.

STATEMENT OF JIM H. CONNER

Mr. CONNER. Mr. Chairman, we appreciate the opportunity to be here. I have with me two gentlemen that I'd like to introduce; Mr. Laird Patterson who is the Washington counsel for Bethlehem Steel Co., and Mr. Brian Turner who is the director of legislation and economic policy for the Industrial Union Department, AFL-CIO.

My name is Jim Conner, I am executive vice president of the American Yarn Spinners Association and chairman of the multi-industry Trade Reform Action Coalition which has been referred to earlier today as TRAC.

On behalf of TRAC, I am pleased to be here today to discuss the need for modernizing our trade laws and making them more responsive to U.S. industries.

TRAC represents a substantial cross-section of American companies, trade associations and labor unions formed over 2 years ago to support the strengthening and modernization of key U.S. trade laws. Our member organizations employ well over 5 million people, and the producing companies account for over $300 billion in annual sales. Industries represented include automotive parts, chemicals, footwear, furniture, leather goods, metalworking, natural and manmade fibers, textiles, apparel, nonferrous metals and steel and steel distribution, to name a few.

The groups before you today at the table represent a very large slice of American manufacturing, and we have two concerns: What is happening to our industries because of unfair and injurious foreign trade practices, and the inability of current trade remedy laws to deal adequately with such practices.

More and more of our industries are hobbled by unfair and disruptive imports and by closed markets abroad. Some economists believe we are merely witnessing a simple shift in comparative advantage that is a natural part of the adjustment process. We should not be fooled.

What we are seeing today is a systematic decimation of America's industrial base. One industry after another, including our most competitive high tech industries, is losing market share as a result of foreign unfair and injurious trade practices. We've lost about 2 million manufacturing jobs since 1979 alone, and these jobs have spanned all manufacturing and have severely impacted some of our most vital industries.

Some jobs have been replaced by new service sector jobs. I submit, however, that a great industrial economy needs more than just service jobs; it requires a sound manufacturing base.

The U.S. economy is today at a crossroads and in dire need of direction. We can continue to pretend that our present trade policy is sufficient while our trading competitors are destroying our most vital industries, or we can take another path and that is to give our industries stronger tools to defend themselves in what is already a full scale international trade war, and a war that we are unfortunately losing.

Some of the tools can be found in the legislation before you today.

The legislation supported by TRAC, H.R. 2809, the Comprehensive Trade Law Reform Act of 1985, will help, we believe, to accomplish those goals. The TRAC-endorsed proposals, in concert with the provisions of H.R. 1950, the Trade Law Modernization Act, will take a giant step toward the achievement of truly effective trade remedy laws. We therefore strongly support both H.R. 1950 and H.R. 2809, and we hope the committee will look favorably on incorporating the very important additional provisions of H.R. 2809 that are not currently a part of H.R. 1950.

Particularly, we would like to call to your attention the recommended changes in the U.S. antidumping and countervailing duty laws. These changes respond to foreign unfair trade practices such as diversionary and persistent dumping, and foreign government subsidies not reachable under current law. This is not uncharted territory for the Congress because virtually all of the recommendations for changes to these statutes were adopted in one form or another by either the House, the Senate or both, by overwhelming margins during the last Congress.

We agree with LICIT about the need for reform of the U.S. escape clause, section 201, to make it a viable remedy for industries suffering from injurious imports, and we agree on the need to revitalize section 301 to make it a workable mechanism for responding to unfair foreign trade practices.

Since the section 201 and 301 measures are covered in both bills, and others on these panels have addressed these changes, I want to concentrate my remarks on the reform of our dumping and subsidy laws.

The importance of these trade remedy laws to American businessmen and workers is not always readily understood or appreciated. Yet, these statutes are by far the most utilized of all our trade laws, and as many businessmen will tell you, often offer the best opportunity for relief from unfair foreign trade practices.

Dumping occurs when a foreign firm sells a product in the U.S. market at a price lower than the price it sells the same product for in its home market or other export market, or, when a firm sells a product in our market at a price that's lower than its average cost of production. Under U.S. law and international rules, before a penalty can be imposed on the dumped import, it is necessary to show that material injury has occurred to the petitioner seeking relief.

Subsidization can occur whenever a foreign government provides an export subsidy, direct cash grant or provides other direct and indirect assistance to an industry whose products are exported to the U.S. market. As in the case of dumping, material injury must also be proved before penalty duties can be applied in subsidy cases.

Unfortunately, however, many subsidy and dumping practices are unreachable under our current trade laws. For instance, while we can take action against directly dumped or subsidized products, there is a gaping loophole in U.S. trade laws regarding unfair trade that is indirect. Current law does not apply at all to dumped inputs that are contained in imports of fabricated products, and existing law only partially reaches imports that are subsidized. The ultimate effect of foreign fabricated imports containing dumped or subsidized inputs is a severe competitive disadvantage for U.S. producers of competing products.

To close this loophole, H.R. 2809 makes actionable under the dumping law the foreign unfair trade practice known as diversionary dumping. This would allow the Commerce Department to pursue investigations where, for example, Japanese steel is sold to a Korean automobile manufacturer, in this case at a dumped price, and the Korean autos containing this dumped steel was then exported to the U.S. market.

Another provision of H.R. 2809 would eliminate the artificial distinction between subsidized capital and subsidized goods or services. It would do this by allowing penalty duties to be applied against loans made on favorable terms and against the provision of goods or services at below market rates. As a result, if a foreign government provides cotton to its domestic textile industry at a below market rate, the U.S. subsidy law could be applied.

H.R. 2809 and H.R. 1950 both specify the kinds of commitments to eliminate subsidies that foreign governments should be required to make in order to qualify for and continue to receive the injury test.

This is necessary because a number of developing countries have agreed to phase out and end the subsidization of their exports to the U.S. market. They have been granted the injury test in exchange. They have continued to subsidize their exports in violation of their commitments, and yet they have continued to get the protection under U.S. law afforded by the injury test in subsidy cases.

H.R. 2809 would require that developing countries phase down and eliminate export subsidies promptly, that the President review compliance on an annual basis, and that the injury test benefit be withdrawn in the event of noncompliance.

H.R. 2809 deals with the serious problem of import surges that frequently occur in the months before or after a petition is filed. Oftentimes a foreign producer will flood the U.S. market with imports just before a case is filed and immediately thereafter in the mere anticipation of the imposition of an offsetting duty on its dumped or subsidized imports.

These surges can be devastating to a domestic firm waiting for a remedy to be imposed, and under current law, such surges may be dealt with by findings of critical circumstances and findings that allow for the imposition of retroactive penalty duties.

However, in pratice, this rarely happens. H.R. 2809 would establish specific guidelines and timetables to facilitate critical circumstances findings in worthy cases.

There are a number of other very important dumping and subsidy provisions in H.R. 2809 that I would be happy to discuss if we had more time.

In all, title I of H.R. 2809 contains 10 essential changes to U.S. dumping and subsidy law. Taken as a whole, they do two important things: They broaden the accessibility of our unfair trade laws to industries that are now denied relief because the laws are either too narrowly defined or are interpreted and administered in such a

way as to limit their applicability; and two, they provide more predictability and fairness as to how these laws will be administered.

Article I, section 8 of the Constitution of the United States states that Congress shall regulate commerce with foreign nations, but in practice Congress has delegated much of the authority for the management of our trade affairs to the President over the years. However, our trade affairs are not being managed well when the trade deficit is at record levels, when industries such as the footwear industry are being ravaged by imports but denied import relief by the President, and when industries such as the semiconductor industry are being seriously harmed by foreign unfair trade practices.

We therefore believe it is time for Congress to reassert its constitutional powers in this area, and we appeal to you to start this process with the recommendations incorporated in the bills our groups have testified on today.

On behalf of all the member organizations of TRAC, I appreciate the opportunity you have given me to testify.

[Testimony resumes on p. 592.]

[The prepared statement of Mr. Conner follows:]

Statement of Jim H. Conner
Chairman
Trade Reform Action Coalition

I am Jim Conner, Executive Vice-President of the American Yarn Spinners Association and Chairman of the multi-industry Trade Reform Action Coalition (TRAC). On behalf of TRAC, I am pleased to be here today to discuss the need for modernizing our trade remedy laws, and making them more responsive to U.S. industries.

TRAC represents a substantial cross-section of American companies, trade associations, and labor unions, formed over two years ago to support the strengthening and modernization of key U.S. trade laws. TRAC's member organizations (a listing is attached to my testimony) employ well over 5 million people, and the producing companies account for over $300 billion in annual sales. Industries represented include automotive parts, chemicals, footwear, furniture, leather goods, metalworking, natural and man-made fibers/textiles/apparel, non-ferrous metals, and steel and steel distribution.

You have here today some very large industry coalitions -- TRAC, the Labor Industry Coalition for International Trade (LICIT), and the Coalition for International Trade Equity (CITE) -- representing workers and companies in very diverse sectors of the U.S. economy. There are basic industries and high-tech industries. There is organized labor and management. The groups before you represent a very large slice of American manufacturing, and we share two concerns: (1) what is happening to our industries because of unfair and injurious foreign trade practices, and (2) the inability of current trade remedy laws to deal adequately with such practices.

More and more of our industries are hobbled by unfair and disruptive imports and by closed markets abroad. Some economists believe we are merely witnessing a simple shift in "comparative advantage" that is a natural part of the adjustment process. We should not be fooled.

What we are seeing today is the systematic decimation of America's industrial base. One industry after another -- including our most competitive hi-tech industries -- is losing market share as a result of foreign unfair and injurious trade practices. Our manufacturing trade deficit was a record $123 billion last year and could soar to $150 billion this year. We have lost about 2 million manufacturing jobs in this country since 1979 alone. These job losses have spanned all manufacturing and have severely impacted some of our most vital industries. They are manufacturing jobs we will never see again. These jobs -- as the President stated recently -- have been replaced by new service sector jobs in the travel industry and in fast food establishments. I submit, however, that a great industrial economy needs more than just service jobs: it requires a sound manufacturing base.

The U.S. economy is today at a crossroads and in dire need of direction. We can continue to pretend that our present trade policy is sufficient, while our trading competitors are destroying our most vital industries; or we can take another path, and that is to give our industries stronger tools to defend themselves in what is already a full-scale international trade war, a war that we are unfortunately losing.

Some of the tools of a more effective trade policy can be found in the legislation before you today. TRAC and our colleagues in LICIT share a common desire to have legislation enacted that will simplify, expedite and make more effective the procedures for relief from unfair or injurious foreign trade practices under U.S. laws. While some slight progress was made toward these goals with passage of the Trade and Tariff Act of 1984, much more needs to be done.

The legislation supported by the TRAC, H.R. 2809, the Comprehensive Trade Law Reform Act of 1985, will help accomplish these goals. The TRAC-endorsed proposals, in concert with the provisions of H.R. 1950, the Trade Law Modernization Act, will take a giant step toward the achievement of truly effective trade remedy laws.

We therefore strongly support both H.R. 1950 and H.R. 2809, and we hope the Committee will look favorably on incorporating the very important additional provisions of H.R. 2809 that are not currently a part of H.R. 1950. Specifically, we call to your attention the recommended changes to U.S. dumping and subsidy laws in H.R. 2809.

These changes respond to foreign unfair trade practices such as diversionary and persistent dumping, and foreign government subsidies not reachable under current U.S. law. LICIT, along with other private sector groups and many members of Congress, recognizes the need for such changes and is supportive of them. Moreover, this is not uncharted territory for the Congress. Virtually all of the recommendations for changes to these statutes were adopted in one form or another, by either the House, Senate, or both by overwhelming margins during the last Congress. However, some of the most important of these provisions were dropped in the conference committee between the two bodies in the waning hours of the 98th Congress.

We believe it is essential to enact all of the reforms embodied in the bills endorsed by TRAC and LICIT. We agree with LICIT about the need for reform of the U.S. "escape clause" (Section 201) to make it a viable remedy for industries suffering from injurious imports, and we agree on the need to revitalize Section 301 to make it a workable mechanism for responding to unfair foreign trade practices. In fact, the Section 201 and Section 301 reforms contained in H.R. 2809 and H.R. 1950 are virtually identical.

Since the Section 201 and Section 301 measures are covered in both bills -- and others on this panel have addressed these changes -- I want to concentrate my remarks today in the area of reform of our dumping and subsidy laws. The importance of these trade remedy laws to American businessmen and workers is not always readily understood or appreciated. Yet these statutes are by far the most utilized of all our trade laws and, as many businessmen will tell you, often offer the best opportunity for relief from unfair foreign trade practices for U.S. industries.

The strong TRAC interest in reforming the trade remedy laws governing foreign dumped and subsidized goods stems from the massive, cumulative damage suffered by TRAC members as a result of dumped and subsidized imports and the inability of U.S. laws to provide prompt and full relief.

Dumping is recognized by U.S. law and international agreement to be an unfair trade practice that can cause great harm. It occurs when a foreign firm sells a product in the U.S. market at a price lower than the price it sells the same product for in its home market or other export markets, or when a firm sells a product in our market at a price lower than its average cost of production. Under U.S. law and international rules, before a penalty can be imposed on the dumped import, it is necessary to show that "material injury" has occurred to the petitioner seeking relief.

Subsidization is also recognized by U.S. law and international agreement to be an unfair trade practice that can cause great damage. Such injury can occur whenever a foreign government provides an export subsidy, direct cash grants, or provides other direct and indirect assistance to an industry whose products are exported to the U.S. market. As in the case of dumping, "material injury" must be proved before penalty duties can be applied in subsidy cases. However, it is unnecessary to prove injury if a country has not signed the international Subsidies Code or assumed "equivalent obligations."

Our subsidy and dumping laws are designed to ensure that *genuinely* competitive U.S. firms are not driven out of business by foreign unfair trade practices. Unfortunately, however, many subsidy and dumping practices are unreachable under our current trade laws. For instance, while we can take action against *directly* dumped or subsidized products, there is a gaping loophole in U.S. trade laws regarding unfair trade that is *indirect*. Current law does not apply at all to dumped inputs that are contained in imports of fabricated products, and existing law only partially reaches inputs that are subsidized. The ultimate effect of foreign fabricated imports containing dumped or subsidized inputs is a severe competitive disadvantage for U.S. producers of competing products.

To close this loophole, H.R. 2809 makes actionable under the dumping laws, in limited circumstances, the foreign unfair trade practice known as "diversionary dumping" (which both houses of Congress passed in similar form last session). This would allow the Commerce Department to pursue investigations where, for example, Japanese steel was sold to a Korean automobile manufacturer at a dumped price, and the Korean autos containing this dumped steel were then exported to the U.S. market.

H.R. 2809 also corrects a drafting anomaly in the 1979 Trade Act that has resulted in an unrealistically restrictive interpretation of what constitutes a "countervailable subsidy" (i.e., a subsidy against which penalty duties can be applied). Under current law, penalty duties can only be applied against capital (e.g., loans) made on terms "inconsistent with commercial considerations" (e.g., below market rates) and against the provision of goods or services on "preferential terms" (e.g., on more favorable terms to one industry than to other industries). This provision of H.R. 2809 would eliminate the artificial distinction between subsidized capital and subsidized goods or services. It would do this by allowing penalty duties to be applied against loans made on favorable terms and against the provision of goods or services at below market rates. As a result, if a foreign government provides cotton to its domestic textile industry at a below market rate, U.S. subsidy law could be applied.

H.R. 2809 and H.R. 1950 both specify the kinds of commitments to eliminate subsidies that foreign governments should be required to make in order to qualify for (and continue to get) the "injury test" (i.e., the requirement of

U.S. industries having to prove injury) under U.S. subsidy law. This is necessary, because a number of developing countries have agreed to phase out and end the subsidization of their exports to the U.S market; they have been granted the injury test in exchange; they have continued to subsidize their exports in violation of their commitments; and yet they have continued to get the protection under U.S. law afforded by the injury test in subsidy cases. H.R. 2809 would require that developing countries phase-down and eliminate export subsidies promptly; that the President review compliance on an annual basis; and that the injury test benefit be withdrawn in the event of non-compliance.

H.R. 2809 deals with the serious problem of import surges that frequently occur in the months before or after a petition is filed. Often times a foreign producer will flood the U.S market with imports just before a case is filed or immediately thereafter in the mere anticipation of the imposition of an offsetting duty on its dumped or subsidized imports. These surges can be devastating to a domestic firm waiting for a remedy to be imposed. Under current law, such surges may be dealt with by findings of "critical circumstances" -- findings that allow for the imposition of retroactive penalty duties. However, in practice, this rarely happens. H.R. 2809 would establish specific guidelines and timetables to facilitate "critical circumstances" findings in worthy cases.

There are a number of other very important dumping and subsidy provisions in H.R. 2809 that I would be happy to discuss if we had more time. I have, however, attached a three-page plain English summary to my testimony giving real world examples of how each of these changes would improve current law. In all, Title I of H.R. 2809 contains 10 essential changes to U.S. dumping and subsidy law and, taken as a whole, they do two important things: (1) they broaden the accessibility of our unfair trade laws to industries that are now denied relief because the laws are either too narrowly defined, or are interpreted and administered in such a way as to limit their applicability; and (2) they provide more predictability and fairness as to how these laws will be administered.

Given the growing problem of foreign dumped and subsidized imports, TRAC commends all of the provisions contained in Title I of H.R. 2809 to this Subcommittee. These are explained in detail in Title I of the section-by-section analysis of H.R. 2809 that is attached to my statement.

Article 1, Section 8 of the Constitution states that Congress shall regulate commerce with foreign nations. In practice, Congress has delegated much of the authority for the management of our trade affairs to the President over the years. However, our trade affairs are not being managed well when the trade deficit is at record levels; when industries, such as the footwear industry, are being ravaged by imports, but denied import relief by the President; and when industries, such as the semiconductor industry, are being seriously harmed by foreign unfair trade practices. We therefore believe it is time for Congress to reassert its constitutional powers in this area, and we appeal to you to start this process with the recommendations incorporated in the bills our groups have testified on today.

On behalf of all member organizations of TRAC, I appreciate the opportunity you have given me to testify.

July 26, 1985

TRADE REFORM ACTION COALITION (TRAC)

Alliance of Metalworking Industries
Amalgamated Clothing and Textile Workers Union
American Apparel Manufacturers Association
American Brush Manufacturers Association
American Chain Association
American Cutlery Manufacturers Association
American Die Casting Institute
American Federation of Fisherman
American Fiber, Textile, Apparel Coalition
American Furniture Manufacturers Association
American Gear Manufacturers Association
American Institute of Steel Construction, Inc.
American Iron and Steel Institute
American Metal Stamping Association (Washer Division)
American Mushroom Institute
American Pipe Fittings Association
American Textile Machinery Association
American Textile Manufacturers Institute
American Wire Producers Association
American Yarn Spinners Association
Anti-Friction Bearing Manufacturers Association
Automotive Service Industry Association
Association of Die Shops International
Association of Synthetic Yarn Manufacturers
Bicycle Manufacturers Association of America, Inc.
Brass and Bronze Ingot Institute
Carpet and Rug Institute
Cast Iron Soil Pipe Institute
Cast Metals Federation
Clothing Manufacturers Association of America
Committee on Pipe and Tube Imports
Copper and Brass Fabricators Council, Inc.
Cutting Tool Manufacturers Association
Expanded Metal Manufacturers Association
Footwear Industries of America, Inc.
Forging Industry Association
Group of 33
Hand Tools Institute
Industrial Fasteners Institute
Industrial Perforators Association, Inc.
International Ladies' Garment Workers' Union
International Leather Goods, Plastics and Novelty Workers Union
Investment Casting Institute
Iron Castings Society
Knitted Textile Association
Lead-Zinc Producers Committee
Luggage and Leather Goods Manufacturers of America, Inc.
Man-Made Fiber Producers Association, Inc.
Metal Cutting Tool Institute
Metal Treating Institute
Metalworking Fair Trade Coalition

National Association of Chain Manufacturers
National Association of Hosiery Manufacturers
National Association of Pattern Manufacturers
National Association of Uniform Manufacturers
National Cotton Council of America
National Foundry Association
National Knitwear Manufacturers Association
National Knitwear and Sportswear Association
National Screw Machine Products Association
National Tooling and Machining Association
National Wool Growers Association
Neckwear Association of America
Non-Ferrous Founders' Society
Northern Textile Association
Outdoor Power Equipment Institute
Plumbing Manufacturers Institute
Scale Manufacturers Association, Inc.
Steel Founders' Society
Steel Plate Fabricators Association, Inc.
Steel Service Center Institute
Synthetic Organic Chemical Manufacturers Association
Textile Distributors Association, Inc.
Tool and Die Institute
United Food and Commercial Workers International Union
U.S. Fastener Manufacturing Group
Valve Manufacturers Association
Welded Steel Tube Institute
Work Glove Manufacturers Association

H.R.2809

THE COMPREHENSIVE TRADE LAW REFORM ACT OF 1985

Title I - Improvements in Antidumping and Countervailing Duty Laws

This Title does the following:

- It makes actionable under Antidumping law, in certain circumstances, the foreign unfair trade practice of "diversionary dumping" (similar to the "upstream dumping" amendment passed by both houses of Congress last year). The provision would only apply where an existing Antidumping order or other arrangement is in effect. This would allow the Commerce Department to pursue investigations where, for example, Japanese steel was sold to a Korean automobile manufacturer at a dumped price, and the Korean autos containing this dumped steel were then exported to the U.S. market.

- It expands the coverage of "upstream subsidies" under the 1984 Trade Act to subsidies provided or authorized by a customs union, and strengthens the law where the input is subject to an existing CVD order or other arrangement. This would allow the Commerce Department to pursue investigations where, for example, the "upstream" subsidy on the input was authorized by the EEC but paid by a member country.

- It allows companies and workers who make major components (which are irrevocably destined for incorporation into final products) to file and participate in Antidumping and Countervailing Duty proceedings. This would enable domestic color picture tube companies, for example, to file and participate in Antidumping and Countervailing Duty cases on color televisions.

- It amends the definition of subsidy to make countervailable the provision of goods or services which are on terms inconsistent with commercial considerations, as well as loans, loan guarantees and equity infusions which are on preferential terms. This would permit the Commerce Department, for example, to countervail against a foreign government that purchases cotton, which is provided to that country's domestic textile industry at a below market rate.

- It specifies the kinds of commitments to eliminate subsidies that foreign governments would need to make in order to qualify for (and continue to get) the injury test under Countervailing Duty law. This would require, for example, that Mexico and other advanced developing countries phase-down and eliminate export subsidies promptly; that the President review compliance on an annual basis; and that the injury test benefit be withdrawn in the event of non-compliance.

- It eliminates the Commerce Department's authority to suspend Countervailing Duty cases on the basis of foreign government export taxes. This would have precluded the Commerce Department, for example, from suspending past CVD cases on Brazilian steel in this manner.

- It waives preliminary ITC injury determinations in Antidumping and Countervailing Duty cases involving products for which there have been recent findings of injury. This would allow domestic companies, for example, to save the time and expense of a preliminary injury determination in "revolving door" cases involving multiple suppliers of the same product.

- It provides for a number of important procedural changes, including: (1) more rational procedures for the disclosure of confidential information under administrative protective order; (2) various limitations on the Commerce Department's authority to conduct "quick and dirty" 90-day reviews of Antidumping orders; and (3) elimination of the ITC role in determining whether "critical circumstances" exist to trigger the retroactive application of duties.

Title II - Improvements in Section 201 (the "Escape Clause")

This Title does the following:

- It eliminates the current role of the President and makes the USTR the "administering authority". This would help depoliticize Section 201 cases.

- It replaces the requirement that imports be the "substantial cause" of serious injury with the requirement that they merely be the "cause" of serious injury. Had this been law in 1980, it is probable that the Ford/UAW petition would have produced an affirmative injury vote.

- It makes relief more effective and certain by strengthening the "threat of injury" concept; precluding adjustment assistance as the sole form of relief; allowing for provisional relief measures in the early stages of investigations if import surges occur; requiring USTR to consult with foreign governments that have contributed to serious injury by targeting export markets or restricting imports of the product; allowing major parts and component producers to file and participate in proceedings; requiring USTR, if dumping or subsidization is uncovered, to consult with affected U.S. companies and workers about taking appropriate action under the Antidumping and Countervailing Duty laws; and permitting petitioners to reapply for relief in less than two years if good cause is shown.

- It establishes an optional alternative procedure designed to provide greater assurance that the relief provided is consistent with the requirements of enhanced competitiveness or adjustment to new methods of competition facing the industry. This involves the voluntary establishment of a tripartite advisory group to assess current problems and recommend a strategy to enhance competitiveness.

Title III - Improvements in Section 301 ("Enforcement of U.S. Rights")

This Title does the following:

- It eliminates the current role of the President and the interagency Section 301 Committee, and makes the USTR the "administering authority". In addition, it provides for strict investigatory and decision-making time lines; written questionnaires to foreign governments; verification of information submitted by foreign governments; and disclosure of confidential information under administrative protective order. These changes would help depoliticize Section 301 and make its procedures more like those in Antidumping and Countervailing Duty cases.

- It defines the term "targeting" and requires the USTR to take corrective action on behalf of domestic companies and workers injured by foreign industrial targeting.

Title IV - Negotiating Objectives

This Title does the following:

- It clarifies that all U.S. products and services, not just high technology products, should be accorded maximum access to foreign markets.

- It authorizes USTR to enter into negotiations aimed at strengthening GATT rules governing conduct by state-owned or controlled enterprises that engage in international trade. Such talks would seek to establish objective standards for determining when state-owned or controlled enterprises are operated on terms inconsistent with commercial considerations.

H.R.2809

THE COMPREHENSIVE TRADE LAW REFORM ACT OF 1985

SECTION-BY-SECTION ANALYSIS

TITLE I - COUNTERVAILING AND ANTIDUMPING DUTY LAWS

SECTION 101 - LIMITATIONS ON ACCEPTANCES OF COUNTRY UNDER THE AGREEMENT

This section amends Section 701 of the Tariff Act of 1930 by requiring that countries "under the Agreement" must commit themselves under the General Agreement on Tariffs and Trade to eliminate export subsidies within one year; not to increase existing export subsidies; not to extend such subsidies to new merchandise or introduce new export subsidies; and to eliminate immediately export subsidies on merchandise which the ITC finds is already competitive in the U.S. market and would be competitive without such subsidization. Least developed countries, as defined in Section 124 of the Foreign Assistance Act of 1961, as amended, are allowed a transitional period of five years to phase out export subsidies, as opposed to higher income developing countries that must eliminate the subsidies promptly.

The Administering Authority would be required to review compliance with the commitments once a year. If noncompliance were found, the designation would be withdrawn. If the withdrawal occurred after the Commission had made a negative injury determination or after an order has been revoked, the negative determination of revocation would be voided.

SECTION 102 - ITC REVIEW OF CRITICAL CIRCUMSTANCES

This section revises the procedural aspects of antidumping and countervailing duty law in four ways:

(1) Instead of requiring a petitioner to allege critical circumstances, the ITA would be required to begin a critical circumstances investigation on the date that it initiates the dumping or subsidies investigation. It would publish a "notice of import surge" whenever it found evidence that imports have increased significantly in response to the filing of the petition.

(2) The ITC would be required to make an affirmative critical circumstances determination if the ITA has made an affirmative critical circumstances determination and if the ITC has made an affirmative material injury determination (not a threat only or retardation of establishment only determination).

(3) The ITA would direct Customs to suspend liquidation of entries under investigation entered 90 days before the anticipated date of the preliminary determination. If no critical circumstances determination is made, Customs would be ordered to liquidate all imports entered before the date of the preliminary determination.

(4) Countries that are not "countries under the Agreement" would be made subject to the critical circumstances provisions of the countervailing duty law.

SECTION 103 - PERSISTENT DUMPING AND SUBSIDIZATION

This section amends Sections 703 and 733 to waive the requirement of a preliminary determination by the Commission in any instance where the Administering Authority determines that, during the year preceding the filing of a petition, the Commission had made a preliminary or final affirmative determination with respect to the same product. This section therefore dispenses with the requirement of a preliminary determination in those instances where successive petitions are filed to deal with imports of the same product from many different countries. In addition, it provides for the waiver of preliminary injury determinations in such instances, without regard to whether the preceding injury determination was made under antidumping or countervailing duty law with respect to investigations of that product.

SECTION 104 - SUSPENSION OF INVESTIGATIONS

This section amends Section 704 (b) to prevent the Commerce Department from suspending a CVD investigation based on a promise by a foreign government to apply an export tax equal to the determined net subsidy (otherwise known as an "offsetting" export tax), thus eliminating the export tax as a basis for suspending a CVD investigation.

SECTION 105 - LIMITED APPLICATION OF 90-DAY REVIEW AUTHORITY

This section amends Section 736(c) by adding three new criters for the institution of expedited reviews of AD orders, and allows for written comments by interested parties before the decision is made to conduct such a review. The additional criteria include: (1) normal AD time lines; (2) evidence of a significant anticipated margin differential; and (3) representative sales as the basis for review.

SECTION 106 - COUNTERVAILABLE SUBSIDY DEFINITION

This section amends the definition of subsidy to make countervailable the provision of goods or services which are on terms inconsistent with commercial considerations (as well as on preferential terms). In addition, it makes countervailable loans, loan guarantees and equity infusions which are on preferential terms (as well as on terms inconsistent with commercial considerations). At present, only the provision of goods or services on preferential terms and/or loans, loan guarantees and equity infusions on terms inconsistent with commercial considerations are countervailable.

SECTION 107 - COMPONENT PART PRODUCERS TREATED AS INTERESTED PARTIES

This section defines "interested party" to permit participation in AD & CVD proceedings by those associated with the production of major parts and components irrevocably destined to be incorporated into the imported article.

SECTION 108 - DIVERSIONARY DUMPING

This section does the following:

(1) It establishes a new Section 771(18) definition of "Diversionary Dumping" that permits a less than fair value dumping analysis to be applied to an input which is the subject of an outstanding antidumping order against the manufacturer or producer of the material or component, as well as to an input which is the subject of a suspension agreement or other arrangement affecting the material or component.

(2) It amends Section 773(a) to include an adjustment amount for diversionary dumping in determining foreign market value.

(3) It amends Section 773(b) to include an adjustment amount for diversionary dumping in determining sales at less than cost of production.

(4) It amends Section 773(e) to include an adjustment amount for diversionary dumping in determining the constructed value of components as well as materials.

SECTION 109 - UPSTREAM SUBSIDIES

This section does the following:

(1) It amends Section 771A(a) to enlarge the third-country application of the upstream subsidy provisions to subsidies paid or bestowed under the authority of a customs union.

(2) It establishes a new Section 771A(b)(3) "special diversion" rule creating a presumption of competitive benefit for an input product where there is a prior subsidy finding or the input product is subject to an arrangement which results in increases in imports of the investigated product.

Section 110 - DISCLOSURE OF CONFIDENTIAL INFORMATION

This section amends Section 777 to make clear that continuing disclosure is to take place pursuant to one application that describes, in general terms, the type of information sought. The initial application may be filed before any information is submitted by any party and may list and request all of the types of information that may be submitted in the case. This application would operate as an ongoing request for release. In addition, this section specifies strict time lines for the release of information under APO, to ensure that current procedures are improved. With regard to those parties that oppose release, such parties would be required to state at the time the information is submitted both why they oppose release and whether they want to withdraw the information should the Commerce Department decide release is justified. Finally, this section requires disclosure of confidential information submitted under a properly filed APO, unless the submitter proves disclosure will cause substantial harm to its business operations, and that such harm outweighs the requester's need for the information.

TITLE II - RELIEF FROM INJURY CAUSED BY IMPORT COMPETITION

SECTION 201 -- INVESTIGATIONS UNDER SECTION 201 OF TRADE ACT OF 1974

This section amends Chapter 1, Title II of the Trade Act of 1974, dealing with authority to grant temporary import relief to injured industries following investigations by the International Trade Commission. In the past, the ultimate decision to grant import relief has rested with the President. This section transfers that authority to the Administering Authority.

This section includes enhancement of an industry's competitiveness as a purpose for which import relief can be sought.

Standing is given to an industry that produces materials, parts, components or subassemblies irrevocably destined for incorporation in an article like or directly competitive with an imported article.

This section replaces the requirement that imports be the "substantial cause" of injury with the requirement that they be merely "the cause of injury." The term "cause" is defined as a cause which is important, even though another cause or other causes, such as a general economic recession, may be of equal or greater importance.

This section also lists additional factors for the International Trade Commission (ITC) to consider in making a determination of threat of injury. These include (1) a decline in market share; (2) higher and growing domestic inventories; (3) a downward trend in production, profit, wages or employment; (4) foreign industrial targeting; and (5) the extent to which diversion of exports to the U.S. market occurs because other markets are closed. The section also provides that imports by domestic producers shall not be considered a factor indicating the absence of serious injury, or threat thereof. If injury is found to exist, the ITC must recommend relief, even if the relief will only assist in remedying the injury. The ITC may also recommend adjustment assistance in addition to increased duties or import restrictions.

SECTION 202 - PROVISIONAL RELIEF UPON FINDING OF CRITICAL CIRCUMSTANCES

This section adds a new subsection to Section 201 of the Trade Act of 1974, permitting the Administering Authority to impose provisional measures should it find that critical circumstances exist. Critical circumstances are defined as instances where a delay in inhibiting a significant increase in imports which occurred over a short period of time would cause damage difficult to repair. Provisional measures may consist of duty imposition, tariff-rate quotas, quantitative restrictions, orderly marketing agreements or any combination thereof. These measures would remain in force until the President revokes them, the ITC makes a negative determination, or 60 days after the ITC makes an affirmative determination.

SECTION 203 - CONSULTATIONS WITH FOREIGN GOVERNMENTS

This section amends Section 201 of the Trade Act of 1974 to provide that when the ITC makes an affirmative recommendation to the Administering Authority, it shall determine whether the foreign government concerned engaged in actions to expand export markets or to restrict imports of the article, and whether diversion of exports to the United States has occurred because other markets are closed. If the ITC determines that either of these conditions has occurred, and the Administering Authority decides to impose import relief, the Administering Authority must consult and negotiate with other producing and consuming countries to seek to establish a multilateral framework for the maintenance and development of fair, equitable and non-disruptive patterns of trade.

SECTION 204 - INDUSTRY ASSESSMENT AND COMPETITIVENESS STRATEGY

This section adds a new Section 204, entitled "Industry Assessment and Competitiveness Strategy." The section accords firms and workers representing a significant portion of the industry the right to request the establishment of an ad-hoc industry advisory group to prepare an assessment of current problems and a strategy to enhance competitiveness for the industry. The assessment and strategy is to set forth objectives and specific steps which workers and firms could usefully undertake to improve the industry's ability to compete or to assist the industry to adjust to new methods of competition. The advisory group is to include in its report a determination of the ability of producers in the industry to generate adequate capital to finance the modernization of plant and equipment, or to otherwise enhance competitiveness, including an estimate of the overall capital requirements of the industry. Copies of the assessment and strategy are to be submitted to the ITC, the Administering Authority, and the Secretaries of Commerce and Labor within 120 days after the ITC began the investigation. The membership of the group is to include appointees of the Administering Authority who are representative of workers and the industry, and employees of the Departments of Commerce and Labor. Staff is to be provided by the Secretaries of Commerce and Labor.

After the assessment and strategy is completed, the Administering Authority will seek to obtain, on a confidential basis, information from individual members of the advisory group concerning how they intend to act upon the recommended objectives and actions in the assessment and strategy, or other actions they intend to take to enhance competitiveness. Such information will be shared, on a confidential basis, with the ITC and the Secretaries of Labor and Commerce.

Failure to prepare an assessment and strategy for the industry may not be a factor considered by the ITC in making either its injury determination, or its relief recommendation, nor may it be a factor in the relief decision of the Administering Authority. The ITC is, however, required to take account of such assessment and strategy in making its recommendation regarding the appropriate relief.

The ITC is also to consider, as a factor in evaluating threat of substantial injury, the inability of producers in the industry to generate adequate capital to finance plant and equipment modernization or enhance competitiveness, as provided in the assessment and strategy.

This section requires the Administering Authority, in determining what, if any, relief to provide an injured industry, to evaluate the assessment and strategy and take account of the probable effectiveness of import relief as a means to improve competitive abilities. The Secretaries of Labor and Commerce are also required to take account of the assessment and strategy in developing their advice.

This section also provides that when import relief is granted and an assessment and strategy for the industry has been prepared, the Administering Authority is entitled to rely upon the actions outlined in the assessment and strategy, and individual confidential submissions, as one basis for granting relief. The Administering Authority is also to establish a review committee, comprised of itself and the Secretaries of Commerce and Labor, to monitor actions taken to improve the competitive position of the industry, including actions described in the confidential submissions. If, after consultation with the advisory group, the review committee considers that recommended actions and objectives in the assessment and strategy or intended actions described in confidential submissions are not being implemented, or are being unsatisfactorily implemented, and that the failure to implement them is not justified by changed circumstances and has adversely affected the overall implementation of the objectives in the assessment and strategy, then it must so notify the Administering Authority. The Administering Authority will then ask the Commission to report under Section 203(i)(2) on the effects of removing relief. After receiving the Commission report, the Administering Authority will immediately consider whether import relief to the industry should be terminated or modified.

SECTION 205 - IMPORT RELIEF

This section provides that if the Administering Authority determines that import relief is appropriate, the Administering Authority shall consult with petitioners and industry representatives as to the advisability of taking action under the countervailing duty provisions of U.S. trade laws or under Title III of the Trade Act of 1974, where there is reasonable cause to believe that such actions would be appropriate.

TITLE III - RELIEF FROM INJURIOUS INDUSTRIAL TARGETING AND UNFAIR TRADE PRACTICES

SECTIONS 301 - ENFORCEMENT OF UNITED STATES RIGHTS UNDER TRADE AGREEMENTS AND RESPONSE TO INJURIOUS INDUSTRIAL TARGETING AND OTHER FOREIGN TRADE PRACTICES

This section transfers all Section 301 authority from the President to the Administering Authority, and authorizes the Administering Authority to act in response to injurious industrial targeting. This practice is defined as any combination of coordinated government actions, whether carried out severally or jointly which: (a) are bestowed on a specific enterprise industry or group thereof, (b) assist such enterprise, industry or group to become more competitive in the export of any class or kind of merchandise, and (c) cause, or threaten to cause, material injury. In addition, this section requires the Administering Authority to consult with representatives from industry and labor prior to reaching any determination; authorizes various actions (including duties, restrictions and negotiated agreements) to restore or improve the international competitive position of the affected domestic industry; and requires that confidential information submitted during an investigation be available for disclosure under administrative protective order.

SECTION 302 - INVESTIGATIONS UNDER TITLE III OF THE TRADE ACT OF 1974

This section requires written questionnaires and verification of all information submitted by foreign governments and corporations; specifies strict time lines in regard to preliminary and final determinations; and requires submission of a written statement to the Congress if the final determination was affirmative and the Administering Authority declines to take any action.

SECTION 303 - MANDATORY ACTION IN CASES OF INJURIOUS INDUSTRIAL TARGETING

This section establishes a separate track for investigations of injurious industrial targeting and, upon an affirmative ITC material injury finding and an affirmative determination by the Administering Authority, requires that the Administering Authority take at least one of a number of described actions to offset the material injury or the threat of material injury from such targeting. In addition, when the Administering Authority determines preliminarily that targeting has occurred, it requires establishment of an advisory committee (composed of representatives of affected domestic firms and workers as well as appropriate federal officials) to develop proposals to improve the competitive position of the industry affected by such targeting.

TITLE IV - NEGOTIATING OBJECTIVES

SECTION 401 - FOREIGN MARKET ACCESS FOR ALL PRODUCTS;

This section amends Section 104 of the Trade Act of 1974 to clarify that the United States objective of securing maximum access to international markets extends to all products, not just high-technology products. In addition, it clarifies, as a principal U.S. negotiating objective, the elimination of those acts, policies, or practices identified in Section 181 which deny national treatment to U.S. industries.

STATED-OWNED OR CONTROLLED ENTERPRISES

This section amends Sections 102 and 121 of the Trade Act of 1974 to require that the United States undertake efforts to secure an international agreement on rules and procedures to evaluate and respond to the maintenance of state-owned or controlled enterprises. This section also specifies the desirable terms of such an agreement and urges the United States to negotiate on the expansion and revision of Article XVII of the GATT (relating to state-controlled enterprises).

Mr. **Florio**. Thank you very much.

Mr. Sheehan.

STATEMENT OF JOHN J. SHEEHAN

Mr. **Sheehan**. Mr. Chairman, I recognize the reality of time, and I would like to summarize my statement, hopefully in a shorter period than it would take to read it, and I would like to do it on that basis.

Mr. **Florio**. Please.

Mr. **Sheehan**. One thing I must say, Mr. Chairman, is that the bills on which we are testifying today come before you and the Congress at a time in which there is a focus upon unfair trade practices and protectionistic measures practiced in foreign markets against our exports. I notice a great deal of emphasis upon that. The second issue that has been emphasized is changes in the monetary policy and currency rates.

I would like to indicate to you, however, that our bill does not necessarily relate to the problems we have in foreign markets against our exports, nor, indeed, is it an effort to get deeply involved with the exchange rates situation. As a matter of fact, we are really with these bills trying to handle the trade policy issues in terms of their impact upon the domestic industries. After listening to the last witness, Mr. Bergsten, I appreciate the comments he made about the trade consequences of the exchange rate.

There was one particular statement that stuck in my mind, namely, that to the degree that intervention in the monetary and the exchange rate system might bring relief, it is relief somewhere down the road. But it is in that interim period that we have a number of industries, certainly the steel industry, in which changes in the monetary policy and therefore changes in the overall trade deficit might take too long before the industry can get itself back on its feet.

So we are indeed really before you, Mr. Chairman, with a change in our current trade law and not necessarily with regard to trade policies in overseas countries.

My purpose for being on the panel is to relate to one particular provision, one particular section in the LICIT bill, namely, that section which deals with changes in the so-called escape clause or 201 section. The proposal provides for a procedure whereby the Government, labor, and industry can voluntarily seek industrial modernization by combining trade relief with other measures.

In terms of the latter issue, namely, industrial modernization, there are a number of industries, like steel, that are in the process of restructuring, and yet the trade laws are silent on these developments. The section 201 changes proposed in this legislation would amend the safeguard provisions of current law so that two things occur.

First, there would be a liberalization of the "serious injury" test which we have to overcome when he applies for 201 relief. Second, in return for the liberalization of the injury test these would be a linkage to a modernization strategy. In other words, there would be a quid pro quo so that the industry affected by, or taking advantage of the more liberal injury test would commit itself to a modernization strategy.

I might indicate that this idea of conditionality has been growing in discussions in the trade field. As a matter of fact, in our own sector the steelworkers and the steel industry have engaged in a tripartite process arranged by both this administration and the previous administration. The idea of tying any Government relief to a condition to modernization was evolving in the tripartite committee deliberations.

For instance, when the trigger price mechanism, the TPM was established against dumped steel, there was an inferred requirement that the industry modernize. There was also the provision that if environmental regulations covering the steel industry were to be stretched out, it would be conditioned upon reinvestment in the industry.

Furthermore, Mr. Chairman, the Steel Import Stabilization Act, which is now part of the Trade and Tariff Act of 1984, provides the Federal Government with the authority to enforce the voluntary restraint agreements which are now being negotiated. However, that enforcement authority is conditioned upon the fact that the industry shall reinvest in modernization.

I think that is an important conditionality which is tied into the continuation of these voluntary restraint agreements.

Also, and I will briefly mention, our experience with having filed the section 201 case last year. As you know, the United Steelworkers of America and Bethlehem Steel filed before that agency, and it is very significant that a number of the ITC commissioners made specific reference to this idea of conditionality if indeed relief was to be granted under the section 201 process.

For instance, Commissioner Lodwich and Commissioner Rohr expressly required relief to be conditioned upon a commitment to modernize. Interestingly the chairman, Commissioner Eckes, while recognizing the use of the remedy period for undertaking reforms, nevertheless felt that it was beyond the statutory authority of his commission to engage in that type of a linkage.

Commissioner Stern also made reference to this idea of conditionality and indicated "that a broad industrial policy for steel would be a new path, and perhaps in the current steel crisis a desirable one, but not in this forum. The petitioners have given the Commission a taste for this approach, but it remains only a vague taste. Such a program requires a national political commitment and should be the work of popularly elected representatives."

I think what I am reading into that statement on her part is that the 201 process could not reach to the things we are talking about before you here in the LICIT bill unless the Federal legislators moved in that direction.

Mr. Florio. To provide the authority.

Mr. Sheehan. To the Government and to the section 201 process to make the linkage between modernization and trade relief.

[The prepared statement of Mr. Sheehan follows:]

TESTIMONY

of

John J. Sheehan, Legislative Director
United Steelworkers of America

Mr. Chairman, Members of the Committee, my name is John J. Sheehan, and I am Legislative Director of the United Steelworkers of America.

At the outset, let me state that our Union believes that American's trade problems require a broad-based, comprehensive and well thought out legislative response such as that provided in H.R. 1950. The bill addresses three areas of concern which correspond to three areas of pressing need in the conduct of U. S. international trade policy:

- o The administration of U. S. trade law, including executive branch consultation with Congress and the private sector;
- o Defining U. S. objectives for multilateral negotiations where new international trade rules are required;
- o Substantive reform of U. S. trade law, particularly where U. S. law and policy have been overtaken by rapid changes in today's realities of international competition.

It is with respect to trade law modernization that I wish to focus my attention.

The bill modernizes parts of U. S. trade law which have been overtaken by the rapid growth and development of innovative trade practices by other countries -- practices to which U.S.trade law has proven inadequate. It provides offsetting action when foreign industrial targeting practices or provision of subsidized raw materials by foreign governments injures opportunites for U. S. producers denied market access by foreign countries, especially when the U. S. unilaterally opens our own market. It updates the authority of the President and Congress to respond to record trade deficits and the overvalued dollar.

And finally, it eases the more stringent U. S. standard for determining trade injury to conform with the international Gatt standard, and provides a procedure whereby government, labor and industry can voluntarily seek industrial modernization, combining trade relief with other measures.

In terms of the latter issue, there are a number of industries which, like steel, are in a process of restructuring and trade laws are silent on these developments. The Section 201 proposal in H.R. 1950 would amend the safeguard or escape clause relief section so that:

- threat of injury test would be substantially liberalized; and
- affected industry would be required to implement a modernizing strategy--the quid pro quo factor.

On March 17, 1983, USWA indicated at hearings before the Ways & Means Committee that trade policy ought to be linked to economic policy. More specifically, we testified that trade relief should be one of the government measures available to companies pressed with restructuring challenges.

While this proposal would not be industry specific, it would, however, rely upon the concept of conditionality; i.e., a temporary restrictive change in trade policy should be tied to industry commitment to reinvestment. The USWA had previously been engaged in a tripartite exercise--Steel Tripartite Advisory Committee (STAC)--during which process certain government measures were extended on the condition that the enhanced profitability of the steel companies, resulting from the measures, would be committed to reinvestment in the industry:

- trade monitoring of steel imports to arrest "dumped steel" through a trigger price mechanism (TPM) inferentially required reinvestment;
- stretchout of environmental regulations statutorily required reinvestment.

Under current law, a petitioner for Section 201 relief must meet very stringent requirements, among which is the "serious injury" or threat of injury test. During a recovery or normalcy period, meeting this test could prove difficult. However, it is during a recovery period and an increase in demand that trade relief, in order to enhance capital formation, would be most beneficial.

The H.R. 1950 proposal accomplishes this purpose by "softening" the threat of injury test so that failure to be able to implement a modernization strategy, jointly developed, because of lack of capital formation due to import penetration levels constitutes the "injury." At the same time, the strategy or plan becomes the condition upon which the relief is extended and maintained.

The proposal utilizes the present regimen of Section 201; namely, the International Trade Commission, which after a hearing and determination on injury, recommends trade relief. The new ingredient is the provision of an option to the petitioner whereby the party can request the U. S. Trade Representative to establish a modernization advisory committee to develop a modernization strategy.

Note that the proposal offers an option to the petitioner. If the petition does not elect to follow this procedure, then the petitioner files under the present Section 201.

Thus:

- o trade relief is the carrot for modernization;
- o the readjustment measure is applicable to a limited number of industries;
- o the procedure remains voluntary and only an option.

CONCLUSION

There is growing support for the concept of trade relief conditionality. The Steel Import Stabilization Act conditioned government enforcement of the steel VRAs, being negotiated by the USTR, upon a modernization and training commitment. There is, therefore, a reasonable expectation that the provision could have a favorable response from a Congress concerned about revitalization of American industry while, at the same time, reticent about restrictive trade measures.

Furthermore, USWA experience with the current Section 201 is instructive. As you know, the Union, together with Bethlehem Steel, filed for relief under that provision. When the ITC recommended import relief after a finding of serious injury, the Commission members were divided on the imposition of a linkage between relief and adjustment.

- Commissioners Lodwich and Rohr expressly required relief to be conditioned upon commitments to adjust: "The effects of this remedy on the U.S. economy are simply too pervasive to permit the remedy to continue without meaningful efforts by the domestic steel industry to adjust to import competition."
- Commissioner Eckes, while recognizing the use of "The remedy period for undertaking the reforms required to make this industry competitive in world markets..." found

"nothing in the statute that invites the Commission to comment upon conditionality."

- Commissioner Paula Stern suggested that a broad industrial policy for steel "would be a new path and perhaps in the current steel crisis, a desirable one, but not at this forum. The petitioners have given the Commission a taste of this approach. But it remains only a vague taste. Such a program requires a national political commitment and should be the work of our popularly elected representatives."

It is significant that the concept of conditionality was explicitly raised within the context of the Section 201 proceedings. Indeed, it indicates that the role of trade and/or trade relief is a definite element in industrial restructuring. At present, Section 201 prevents our trade policy from rising to the challenge of being part of an industrial strategy.

The notion of trade relief "conditionality" has been released with the Industrial Competitiveness Act (H.R. 4560), the House Banking & Currency Committee stated:

> Because different industries have different problems, some forms of industry-specific actions are needed. Trade relief provides one form of such action...Far too much of existing trade policy is disconnected from any strategy for rebuilding an industry to be world class competitive. Protectionism is often granted without sufficient conditionality -- There are no "strings" attached to the relief which would ensure that this aided industry use the relief to modernize itself for world class competition.

We feel that the trade law modernization included in H.R. 1950 is fully consistent with the recent conclusions and recommendations of the President's Commission on Industrial Competitiveness. The President's Commission emphasized the need for labor, industry and government to work together on how we can best address the challenge of international competitiveness facing our country and our individual industries.

One expression of that same intent, as is the option under the "escape clause," Section 201, is for industry, labor and government to sit down together when an industry is injured by imports and develop a strategy for enhancing the competitiveness of the injured industry. This means a greater likelihood for success in strengthening an industry impacted by trade compared to the option available under current law: restraining imports for a limited period of time and then hoping that the industry can adequately strengthen itself in the interim.

We believe that our recommended approach is the proper way to proceed and we urge your speedy consideration of this bill.

Mr. FLORIO. You heard Mr. Feketekuty this morning say that the administration has a philosphic opposition to any of that conditioning, any of those actions being put forward because they regard it as industrial policy. I suppose my only apprehension is that we can do, and I am inclined to want to do what is suggested here, but nobody should hold out the prospect that it is going to mean anything because ultimately, unless the Congress is going to sit and pass on specific conditions, which is obviously impracticable, if you don't have the commitment at the ultimate agency decisionmaking level, whether it be the President or if we delegate it to somebody else, it is just not going to happen even though you have the authority.

Mr. SHEEHAN. There are two points that I would like to make with regard to your comment, Mr. Chairman. One relates to whether an industry can successfully petition under the section 201 process. A statutory change, in our view, is necessary in the law so that a successful section 201 petition statutorily could lead to a recommendation.

In other words, you have to do something with the very severe injury test that is in the current law so that an industry, which is seeking relief in order to implement a modernization plan, would be able to meet the injury test if the law changes.

The second situation, however, is whether the administration would, based upon the modernization plan that would be developed, followed through with the relief that would be recommended by the ITC. First of all, I would note that in our legislation—whether it would be as efficacious as we hope it might be—whereby we remove the decisionmaking authority from the office of the Presidency directly and place it in the administrative agency.

That may or may not have the effect of depoliticalizing the decision on the part of the adminstration.

Second, it is interesting to note that when the administration previously granted relief, for instance, to the speciality steel industry, it did make reference to the fact that it hoped that this period would be used for the modernization period.

So I don't necessarily think that it would be resistant to making sure that if the industry was getting trade relief, that there ought to be a statutory requirement that it do so.

Third, I do note that there is a great deal of criticism against industries that seek trade relief against imports which are outside of the so-called unfair trade practice problems unless there is some condition being applied on the relief granted. What we have done in this legislation is to move the conditionality requirement a step further in a limited way.

There are many that say you ought not to give any relief unless there is a condition. We don't go that far. We just indicate that in a limited area where an industry is willing to sit down and try to look at the modernization problem it has, the lack of capital formation, and at that point put together an industry plan of modernization.

Presently the steel industry is under that mandate from the Congress.

Mr. FLORIO. Was there any discussion of this latter approach in the shoe industry case, the modernization concept, asking for relief conditioned upon some opportunity to hold out the prospect for an improvement in the productivity of the industry?

Mr. **Patterson**. Mr. Chairman, I was not specifically involved in the shoe case, but it is my understanding, knowing some people who were, that it was because of the nature of the shoe industry being literally thousands of fairly small manufacturers that it was perceived to be a fairly impractical approach as opposed to, say, the steel industry where last year something very close to this, in fact, occurred with a smaller number of companies.

A good example of where it did work was the motorcycle case, Harley-Davidson, one company that came in with a very specific modernization plan and got relief and is doing pretty well.[1]

Mr. **Florio**. Let me ask Mr. Brennan with regard to his concentrating on the question of targetting: More realistic definitions to targetting on the targetting problem, do you think that is going to do any good if we are able to define, but at some point, when one defines targetting in a more expansive way as you suggest and as the legislation suggests, it is still going to take some decisionmaking at the end as to what the sanction is.

There is a problem at this point with the philosophy that is prevailing. What is going to change? What is going to change that if you do target—you target chemicals coming in because overseas energy policies are artificially providing a subsidy to the chemicals that are coming here. We make that decision. We make the decision that there is targetting taking place. So what? How do you foresee the passage of this law changing the bottom line, which is the sanctions that would be taken against a nation that became involved in targetting or unfair trade practices?

Mr. **Brennan**. I think our feeling, sir, is that the first step is to recognize targetting as an unfair trade practice, and that is what we are trying to do here. My suggestion was to try to broaden that definition, at least in the legislative history, so that people understand what we are talking about, and the administering authority can't say, gee, I didn't know that's what you meant.

Then when you get to the solutions, I think the bill provides for a variety of flexible solutions. I believe if it passes the way it is, if injurious foreign industrial targetting is found, then action is mandatory.

Mr. **Florio**. Opponents, I assume, would say that it is almost impossible to ever define those things. For example, they might ask if we are reopening ourselves up to somebody attacking us because the Defense Department has become involved in a program to facilitate the development of super computers, isn't that targetting? Or in the production of aluminum. Every State has a public utilities board that regulates the cost of electricity. Aluminum is a very electricity-intensive industry. Haven't you provided an indirect subsidy and therefore—you can go on and give multiple examples.

Is there any validity to that?

Mr. **Brennan**. I don't think so. In fact, I think the retaliation argument, which is what you're making, is really a copout to inaction.

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[1] (See letter on p. 652 from Mr. Jim H. Conner pertaining to the foregoing testimony.)

The CBO in January 1984 as I recall put out a study that indicated U.S. Government support of manufactured and agricultural industries. I'm going on my memory, but I think the manufacturing help from the U.S. Government was about 0.05 percent; less than 1 percent. In the agricultural area, it was a bit more. Quite a bit more.

My thought is that if we really have these bad things, let's roll the dice and take a chance. My feeling is that we don't. If you look at history, we've had very few countervailing duty cases brought against us. Not that many dumping cases. So that there really isn't that much in the way of our doing things that—I'm not trying to say we're lily white and there aren't some areas where I'm sure we couldn't be vulnerable, but I think our vulnerability on a scale of 100 is maybe 5, and there are other countries that are probably in the area of 80 to 90.

Mr. **Florio**. Let me just make one last point, and I made this point to one of the previous witnesses on a different panel. What happens if it's us, the United States, that is out of step with the rest of the world, and that others regard targeting—you may think of a different way of describing it—as an inevitable part of national sovereignty, which is preserving the strongest economy that you have domestically. There are industries that you may want to further and therefore there's nothing wrong with having the central bank tilt to provide capital to preferred industries that you want to develop. Everyone may feel there's nothing wrong with that and therefore, you're not going to change those industries.

If we ever came to that realization, is there some value in making the determination that maybe we should get back in step with everyone else, and that it's in our national interest to start targeting to insure that we have a viable steel industry, and take those self-help measures that are designed to provide preferable rates for capital to retool key industries? Is there an argument that at some point we should start, in our national interest, to target?

Mr. **Brennan**. Our group I think would react to that by saying we would refer you to that second map, where it shows that your one point I think is accurate. The map, in essence, shows that there is one place in the world that practices minimal Government intervention, and that is Hong Kong. There are 12 countries that have moderate intervention; that is the United States. The developing countries and Japan have extensive government involvement.

So there is a difference in economic systems. And I think in your commentary with Geza Feketekuty this came up. Our feeling is that the sovereign right of other nations is, indeed, just that, and that what they do within their own borders as long as it doesn't impact international trade is their business. But I think if they're going to be part of the world and part of the GATT, if they move products across borders or do things to keep things from coming into their border, then they've got to live by some different rules.

And I think what we're seeking is to have a more open, fair international trading system, to reestablish that system, and we feel that by having tougher trade law reform, tougher trade law actions then we'll begin to get people to realize that we're serious and that we'll go at it by trying to get the system back in whack, rather than change economic systems.

That's basically our thought.

Mr. **Turner**. Mr. Chairman, may I supplement Mr. Brennan's remarks?

Your questions, as usual, are very sharply to the point on targeting. Let me go back on your last three specific points from the point of view of someone who has worked at an institution; the Industrial Union Department has worked very closely on this.

Your first question was how do we know that the administration would do anything, even if an allegation can be proven that there is injurious targeting. This bill as written provides that the administration, while it has a completely wide open menu of responses among which it can choose, must move to fully offset the cause of the harm. That is language which, to my knowledge, doesn't exist anywhere now in U.S. trade law. And if the administration—any administration—should choose to respond insufficiently, then I should think they'd have an issue to discuss with the Congress, faced with that kind of a very clear charge.

Second, you asked about the question of retaliation; are there sectors, for instance, defense-related sectors, where the United States is providing such massive support that it could be harming industries in other countries. We analyzed that question very closely in reviewing the bill and helping to shape it, and came to the conclusion that in almost every case, the countries that would be interested perhaps in reacting to U.S. assistance of that type, in fact, are engaged in the very same practices themselves.

If you think about super computers, say, in Japan or Germany, those are countries that have also very active government support programs for super computers. They are very unlikely, therefore, in the context of a hypothetical mirror legislation instance, to move against us if they would themselves be equally vulnerable. So they seem to match. Likewise in aircraft and other high tech sectors.

Third, on the point that you made earlier——

Mr. **Florio**. Although on that last point, in our domestic content discussions around here, the opposition that we got from overseas countries; namely, Japan, to domestic content did not in any way inhibit them from imposing domestic content restrictions on purchases of Boeing airplanes; at the same time some inconsistency and logic may sound like an appropriate response, but it's not always appropriate.

Mr. **Turner**. I'm not defending the consistency of other countries; merely of this legislation, sir.

The third question, the one that you raised both now and earlier this morning, is the one of economic sovereignty; doesn't this country, and in fact any country, have a right to say it needs to have a viable steel industry, and therefore to take steps that might be called targeting to assure that result when market forces alone would not produce it?

I think everyone agrees that that's something that countries have to be able to do, but there's a difference which is also very clearly drawn in this bill, between measures which assure the viability of an industry domestically, and measures which so target the industry for export development that the product is exported and displaces workers and investment and production in another country or in a series of other countries.

It's that export-oriented targeting which is the object of sanctions proposed in this bill, rather than the exercise of what I agree with you should be called economic sovereignty for strengthening industries domestically.

Mr. **Florio**. Let me just follow up on the last point. The domestic viability of the Japanese economy is contingent upon export viability. The Japanese I think a long time ago said they can't exist as a domestic economy without the capability. And I'm not in any way finding differences of opinion; I'm just suggesting that I have some skepticism about whether we can be successful in inducing massive cultural changes, massive economic changes in the way that other nations have conducted themselves. The way they conduct themselves may not be in accordance with our perception of free market forces; nevertheless, what they're going to be doing is continuing to do what they've done in the past—targeting and things like that. And therefore, we do have to become a little more forceful, and I suspect that's what your goal is as well.

Let me just conclude so I can recognize the gentleman.

Mr. **Broyhill**. Thank you very much. I note that on this panel there are witnesses who are representing various groups of people who are endorsing different bills. For example, LICIT, TRAC, and CITE. My question is whether or not there is some meeting of the minds here with respect to a bill that we could use here in this committee, that would meet all of the concerns of the witnesses at the table.

They are all similar bills, they all approach the problem from the same direction. Is there any comment from the various members?

Mr. **Sheehan**. Well, I would say yes, Mr. Broyhill. The bills are not incompatible. They are not in contra-distinction to one another. Some focus on one aspect of the trade problems; others focus on others. And to the degree that the committee sees a more comprehensive pattern evolving, obviously it surely would meet our own concerns.

Mr. **Brennan**. CITE does not have a bill per se, and we endorse the targeting provisions, title IV, of H.R. 1950.

Mr. **Broyhill**. Mr. Conner.

Mr. **Conner**. From TRAC's viewpoint, if you look at the 201 and 301 sections I think you will find them very similar to those being offered by LICIT, and no question about it; I think there is a sound basis for a common bill, and certainly in many cases the language of both bills is the same.

Mr. **Broyhill**. What about the other two gentlemen? Agreed?

Mr. **Turner**. Yes, sir.

Mr. **Patterson**. Yes, sir.

Mr. **Broyhill**. Well, we thank you for those comments. I'd like to get some comment on this. Are any of you economists here in this panel? [No response.]

The argument that we hear from the administration is that the Congress and the administration working together to do the right thing and get the budget deficit down, and get the Government out

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of the money markets and that that will lower interest rates, and that that will have the effect of lowering the value of the dollar in relationship to foreign currencies. And that that one factor; that is, the high exchange rate of the U.S. dollar, is the one factor that has contributed to the problem, and that if we can solve that part of the problem, that will go a long way toward restoring competitiveness to domestic industries and help us export as well.

Do you agree with that evaluation? And while I am speaking, I think that there is some economic view out there that if we did the right thing and got the budget balanced, it could make the dollar even stronger.

Mr. **Sheehan**. Mr. Broyhill, the witness just previous to us was an economist and I thought gave a rather excellent discussion of the relationship between trade deficits and trade policy.

I think he was at pains to be very open about the fact that the trade deficit issue, which is obviously related to the currency exchange rates is not, in that technical sense, a trade problem. Furthermore, if you adjusted the trade deficits and finally brought them down, you would still not necessarily be handling sectoral trade policies or problems.

A case in point—the more recent rise in the trade deficit in this country—$123 going on $150 billion—has occurred just recently. And yet in the steel industry we have been subjected to particular trade problems long before this unbelievably phenomenal rise.

I guess what I would put to your question is that we should not just simply use as a substitute for trade law reform the handling of the monetary and deficit problems; we should handle those problems. That has to be done. But we may still be left with trade policy problems as they impact on sectors, or as they impact on unfair trade practices. I think we have to address them even if we bring our dollar into a proper relationship.

Mr. **Broyhill**. Thank you for that comment. Would anyone else like to comment?

Mr. **Conner**. I would like to make one comment on it. The question of being able to bring the dollar down and having an effect on exchange rates—it's kind of like a roller coaster. It's heading in one direction now but what direction will it be heading in 6 or 8 or 10 years from now. I don't think there is any assurance that even if you bring the exchange rates down, that they are going to stay there.

What we are talking about in the area of trade law reform is a longer-term leveling of the playing field or establishment of the rules of the game that international trade is going to be conducted under.

I was interested in some of the discussion this morning—free trade versus fair trade. It's one thing to be in favor of free trade. You talk about fair trade as long as it doesn't prohibit anybody's goods from coming into the country. And that is part of the uncertainty, and part of the, I suppose, difficulty that a lot of businessmen are having today with understanding how if you are able to do some of these things that the President announced recently, what assurance do we have that once the administration is out from under the pressure of Congress at the moment, that those things will be carried out in the future.

Some of the things that we are looking at in the area of trade law reform provide longer-term stability in dealing with these problems.

Mr. BROYHILL. I thank you for those comments, and I regret that due to other conflicts and the bells ringing all day I have not been able to spend more time here in the subcommittee. But these are good hearings and I want to commend the chairman for his patience in conducting these hearings.

Mr. FLORIO. Let me not only express my appreciation for the active participation by Mr. Broyhill in the formulation of some of these legislative proposals, but also express my appreciation not only to this panel of witnesses but all the witnesses today. This was a particularly good hearing today, in bringing forth a lot of insights to, in a sense, almost do what we don't need to be doing which is to indicate how complicated this field is.

But at the same time, I think there is a need for an appreciation of a full understanding of the problem before we can even start to address it.

It's been an extremely good hearing and I appreciate that. And if there's no further business we will excuse this panel, and the subcommittee will stand adjourned.

[Whereupon, at 1:35 p.m., the subcommittee meeting was adjourned.]

[The following statements and letters were submitted for the record:]

STATEMENT OF CARGILL, INC.

Testimony Before the
Subcommittee on Commerce,
Transportation and Tourism
of the
House Committee on Energy and Commerce

October 3, 1985

Mr. Chairman and members of the subcommittee, my name is James Schultz. I am the Operations and Administration Manager of the Fertilizer Department of Cargill, Inc. Among other fertilizer operations, Cargill is involved in nearly every phase of nitrogen fertilizer importation, domestic production and distribution.

I appreciate having the opportunity to testify before you today in opposition to legislation that would subject foreign products that receive favorable natural resource pricing treatment to countervailing duty penalties upon importation into the United States. Such a provision is included as Section 502 in H.R. 1950, the proposed Trade Law Modernization Act of 1985.

Cargill, Inc. has testified twice before the House Ways and Means Committee's Subcommittee on Trade in opposition to this controversial proposal. Our ongoing analysis of the international agricultural industry and the international fertilizer business leads us to continue to oppose such proposals as contrary to U.S. trade interests, to the U.S. economy, and to U.S. agriculture.

Cargill bases its opposition to such natural resource proposals on two grounds. First, as both an importer and domestic producer of nitrogen fertilizers, we believe that the problems in the fertilizer industry that originally gave rise to complaints were not then rooted in unfair competition and, in any case, are now passing from the scene. Second, as a major agricultural business and international trader, Cargill opposes any legislation that would subject comparative advantage in natural resources to countervailing duties, as the imposition of such penalties would seriously harm the ability of U.S. agriculture to compete in the international marketplace, and could lead to retaliatory actions that would depress farm sales, prices and economic activity further.

Let me say as a threshold matter that Cargill does not believe that foreign governments' natural resource pricing practices that are the subject of Section 502 of H.R. 1950 constitute a violation of international trade law principles. On the contrary, Cargill believes that any effort to reclassify what is in actuality the legitimate exploitation of generally available resources will violate our obligations under the General Agreement on Tariffs and Trade.

In addition, Congress must take into consideration the implications of any action that it may take for the overall U.S. economy as well as for specific sectors of that economy. It is for this reason that I am here today to discuss both the opposition of Cargill, Inc., to natural resources legislation and the concerns of the U.S. agriculture industry generally.

I. The U.S. nitrogen fertilizer industry is recovering from a recent downturn that was caused by cyclical problems in the domestic market, and not by foreign governments' pricing policies affecting raw material inputs.

The U.S. nitrogen industry is continuing to recover from a recent cyclical downturn that was caused by a combination of factors, including the 1982 recession, a severe drought throughout the farm-belt, and the recent Payment-In-Kind program, all of which reduced farm demand for fertilizer and precipitated a roughly one-quarter decline in nitrogen use. This recovery is occurring even though U.S. grain exports and farm incomes continue to be depressed. If exports and the general farm economy should strengthen, the outlook for the domestic nitrogen fertilizer industry should improve even further.

As an indication of the current health of the U.S. fertilizer industry, U.S. nitrogen fertilizer prices have shown substantial recovery. For example, NH_3 prices FOB New Orleans this year have been running at approximately $150 per short ton, up from $120 a ton two years ago.

Moreover, this spring domestic ammonia production increased by 13 percent over a year ago, production of nitrogen solutions were up by 22 percent over a year ago, and urea production was up by 25 percent. As a further indication of the health of the domestic fertilizer industry, the United States is now exporting ammonia and urea again, while only two years ago the export market for U.S. product had all but disappeared. Finally, increased demand has resulted in the coming back on line of most U.S. ammonia and urea plants, which had previously been idled.

This turnaround in the U.S. nitrogen fertilizer industry bears out the observations Cargill has made previously on natural resource pricing. We have said before and re-emphasize today that foreign countries' pricing policies with respect to their natural resources have had little direct impact on the domestic nitrogen fertilizer industry. The problems that were being experienced by the U.S. nitrogen industry were endemic to an industry characterized by large cyclical swings in demand; production capacity that comes on stream only with a long lead time, in large volumes and with a relatively long useful life; and technology and economies of scale that generate progressive reductions in production costs.

To these chronic factors had been added additional disruptive influences that aggravated a downswing in the industry's predictably cyclical nature. These additional influences included price controls on natural gas in this country; the opening of new, low-cost gas fields and nitrogen production operations abroad; and an unprecedented 80-million acre reduction in U.S. planted acreage in 1983. This point can be illustrated by a quick review of recent industry history.

The nitrogen industry enjoyed an unprecedented seller's market during the mid-1970's and a relatively good market at the start of this decade. Total U.S. fertilizer consumption rose from 43 million short tons in 1975 to 54 million tons in 1981. Nitrogen use ballooned from 8.6 to 11.9 million short tons in the same period, a 40 percent increase.

This upward trending demand encouraged U.S. firms to invest in even further plant expansion. Unfortunately, the anticipated further growth in use did not materialize. This expansion trend, which was worldwide, led to what is perhaps the greatest cause of the problems experienced by the U.S. fertilizer industry: excess worldwide capacity. This same problem of over capacity is being experienced in the potash and phosphate industries as well.

In the United States, the 1980 Soviet grain embargo, a prolonged worldwide recession, falling inflation and rising unemployment, mounting liquidity problems among developing countries and a strong U.S. dollar combined to drop U.S. grain export volumes by over 20 percent since 1980. Domestic grain use also has stagnated. As surplus grain stocks drove prices down, farmers, caught in the cost-price squeeze, cut back on inputs such as fertilizer. The PIK program only added to the fertilizer industry's problems by taking 80 million acres out of production in 1983.

As a consequence of these diverse factors, total U.S. fertilizer use in 1983 fell to below 43 million short tons, less than in 1975. Nitrogen use fell even harder, declining by roughly one-fourth.

U.S. ammonia production was cut back sharply, from 19.3 million short tons in 1981 to less than 14 million tons in 1983. Earnings fell and substantial excess capacity emerged.

In this respect, the nitrogen industry's problems resembled those elsewhere in agriculture. Farm equipment sales plummeted during the same period, with well-publicized effects on firms such as International Harvester. The effects on industries marketing and processing the output of U.S. farms were similar. At one point, 30,000 covered hopper cars and 3,000 grain barges were idled. U.S. exporters — anticipating demand growth — had continued to build facilities. So today, export elevator capacity amounts to nine billion bushels, compared to exports in recent years of 4.2 - 4.4 billion bushels.

Clearly, the nitrogen industry's recent problems stemmed overwhelmingly from a cyclical downturn in U.S. agricultural markets after a decade of unparalleled growth. It was a pattern repeated with varying degrees of severity in most agricultural sectors of the economy. The fertilizer industry's situation would not have been materially different if the world nitrogen market had been simply subtracted away.

In addition to this cyclical downturn in U.S. agricultural markets for fertilizer, the world nitrogen industry is being restructured as technological change, scale economies, and raw material costs shift comparative advantage. Cost savings from each of these three factors is large. For example, D. Gale Johnson, a noted agricultural economist, has pointed out that 1974-level technology can pay $1 more per mcf for natural gas and still produce nitrogen more cheaply than 1960-level technology.

Scale economies are an important cost factor as well. The Fertilizer Institute's recent ammonia cost production survey shows that a plant producing 1000 tons per day has a per-ton production cost about half of the per-ton cost for a plant producing less than 600 tons per day with comparable raw materials cost ($96.76 per ton vs. $179.55).

Technology and scale economies, in other words, have the capacity to drive an enormous structural change in the world nitrogen industry. That is exactly what has been happening. The United States became a marginal net importer of nitrogen again in 1982 and that trend continued through 1984. In 1985, however, reduced imports and substantially increased U.S. export volumes may well result in our again becoming a net exporter.

Western Europe — for many years the major exporter of nitrogen fertilizer — also became an even larger net importer 1982. Japanese net nitrogen exports have been cut nearly in half since 1978/79, and Korea saw its net nitrogen exports fall 40 percent in the same period.

Remarkably, total world nitrogen exports have remained relatively steady at roughly 12 million tons annually over the past several years, even as this structural change has occurred. New, more-efficient nitrogen exporters are by and large displacing traditional exporters rather than squeezing out producers in importing countries. These new exporters, who built modern large-scale plants, also are countries with surplus natural gas resources and a desire to add value to their gas exports.

In a market suffering from a cyclical downturn and experiencing a cost-driven restructuring, low-cost producers determine market prices. In fact, the world nitrogen market has been a buyer's market since 1981. As usage declined while new capacity came on stream, prices fell to restore the balance by forcing high-cost producers to shut down. Since the most efficient, large-scale U.S. plants have costs substantially less than those of smaller plants, there was ample room for prices to fall.

In this environment, nitrogen exporters are price-takers. They are compelled to meet these falling prices or surrender markets. The available evidence suggests that is what happened, as total world nitrogen exports have not grown appreciably. Moreover, there is no evidence that exporters enjoyed subsidized natural gas prices. In fact, the Commerce Department found in its anhydrous ammonia investigation that "Pemex's internal costs for natural gas used in ammonia production exceeded the price of natural gas for industrial users in Mexico...."

Finally, it should be noted that the nitrogen plants operating in the Louisiana and Texas Gulf were by and large constructed to take advantage of the cheap gas available during the 1960's. In fact, their construction caused the shutting down of an even earlier generation of inland plants.

In the coming decade, restarting, modernization, and expansion of plants in high usage areas will cause the restructuring of the domestic industry again. Technological change and scale economies may be part of the cause. Even more important is the rapidly changing price of natural gas supplies under decontrol. And, transportation cost advantages from proximity to users have re-emerged as a key domestic market factor, as it is cheaper to ship natural gas than it is to ship fertilizer.

In other words, the U.S. nitrogen fertilizer industry has been highly cyclical from its beginning. The downturn since 1980 was especially pronounced because of a combination of long-term adjustments, miscalculations of anticipated growth in demand, and a series of one-time corrections in policies all pushed performance down. Against this backdrop, the pricing practices of foreign governments do not explain recent nitrogen price trends. And, the U.S. industry's improved performance over the past two years only adds further evidence that foreign governments' pricing policies are of marginal relevance to the economic performance of the U.S. nitrogen industry.

II. The natural resource bills before this Congress will hurt the ability of U.S. agriculture to compete in the world market.

Congress should be especially careful to examine thoroughly the "downstream" effects of these legislative proposals throughout the U.S. economy, particularly in agriculture. Agriculture and other industries either rely on low-cost natural resource inputs to be competitive in the world marketplace or would be affected adversely by retaliatory or other trade actions that might be imposed by foreign governments should the United States seek to restrict the importation of products that may have benefited from such pricing policies.

It is essential that farmers continue to be able to purchase fertilizer inputs at the lowest possible price. Nitrogen trades in a world market, and the imposition of duties or import restrictions will raise U.S. farmers' costs relative to their competitors'.

U.S. farmers already are experiencing a serious credit crisis at the same time that the strong dollar and a slower economic recovery in the rest of the world are hampering their ability to sell grain and other agricultural products overseas. Higher fertilizer prices would only exacerbate farmers' severe financial problems and further reduce the competitiveness of their products in the world export market.

In fact, a recently completed study by Economic Consulting Services shows that duties imposed under the proposed legislation would increase U.S. nitrogen fertilizer prices by 20 percent, triggering an 8 percent decline in fertilizer consumption and virtually barring the importation of nitrogen fertilizer imports from the subject countries. U.S. farmers, as the principal consumers of nitrogen fertilizer, will be forced to pay the entire cost of this price increase, effecting a direct transfer of some $500 million from consumers to U.S. nitrogen fertilizer producers.

In turn, higher fertilizer costs and resultant lower consumption will result in lower yields in key crops such as wheat, soybeans and corn. According to Economic Consulting Services, as many as 17,000 jobs in the agricultural sector and an additional 32,000 jobs in agriculture-supported sectors would be jeopardized by the lower yields and lost farm revenues to which this legislation could ultimately lead. The nearly 50,000 jobs lost in the agricultural and agriculture-related sectors far outweigh the potential gains of 3,000 jobs in the U.S. agricultural petrochemicals industry that the protection afforded by this legislation would yield. In fact, if new jobs are to be created anywhere under natural resources legislation, they are likely to be found in countries such as Trinidad, where four new fertilizer projects are under development, and Venezuela; not in the United States.

Furthermore, any change in our treatment of nitrogen imports will have serious implications for developing countries, which are relying on value-added industries and the exploitation of their comparative advantages to alleviate unprecedented debt burdens. The industrialization of such countries also in many cases represents sound market development for U.S. export-oriented industries, including the fertilizer industry, and ammoniated phosphates in particular.

Finally, the trade implications of any restrictions that the United States may put on imports of products reflecting natural resource cost and other advantages possessed by our trading partners militate against such natural resource legislation. All U.S. export industries — but agriculture in particular — would be likely targets for retaliatory measures by international trading partners in the event that the United States sought to impose duties or other restrictions on such imports. It was reasons such as these that led agricultural organizations to oppose the 1984 trade bill in the form in which it was taken up by House-Senate conferees last fall.

Actions directed towards foreign governments' natural resource pricing policies thus have broad policy and economic implications for U.S. agriculture and the U.S. economy generally. Agriculture's trade surplus has declined and leveled off in the past few years in response to the same strong dollar that has hampered other basic U.S. industries' ability to compete internationally. Congress should not now be considering any legislation that will exacerbate this already harmful situation.

STATEMENT OF
THE
COALITION TO PROMOTE AMERICA'S TRADE
BEFORE THE
SUBCOMMITTEE ON COMMERCE, TRANSPORTATION AND TOURISM
OF THE
COMMITTEE ON ENERGY AND COMMERCE,
UNITED STATES HOUSE OF REPRESENTATIVES,
ON H.R. 1950,
THE TRADE LAW MODERNIZATION ACT
OF 1985

Of Counsel

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October 3, 1985

EXECUTIVE SUMMARY

The natural resource subsidy provision of H.R. 1950 (section 502) is unnecessary and ill-advised. First, present U.S. trade laws -- most particularly section 301 of the Trade Act of 1974 -- already reach the pricing and access issues raised by proponents of natural resource legislation. Second, the proposal suffers from serious conceptual flaws and would give rise to grave economic and trade-related repercussions.

1. Section 301 of the Trade Act of 1974 already provides a remedy for the practices complained of.

- The range of unfair or unreasonable practices covered by section 301 is far more flexibly defined than under the countervailing duty law, as are the available forms of relief.
- Questions of reciprocity and the denial of equivalent access for U.S. producers to foreign natural resources fall squarely within the scope of the statutory language.
- Some sixty percent of section 301 cases have been successfully resolved -- principally through bilateral consultations with the offending nation.
- Section 301 has been used to resolve actions against such countries as Canada on certain tax practices, Argentina on leather, Taiwan on rice, China on various import practices -- countries and products or practices as to which diplomatic and political sensitivities are acute.

2. The natural resource subsidy proposal is not intended to attack the provision by governments of natural

resources at prices below the fully allocated cost of production. This problem can be effectively addressed by current U.S. antidumping law. Rather, the proposal would radically redefine the concept of unfairness to include situations in which it is determined that government sales -- while made at prices not only above fully allocated cost, but above fully allocated cost plus profit -- were not profitable enough. This radical expansion of the countervailing duty law suffers from the following defects:

- The legislation holds governments to a standard of business behavior that private companies often do not and are not expected to satisfy.
- The proposal conflicts with the internationally accepted view of the scope of legitimate government activity.
- The proposal condemns government activities in the regulation of a nation's natural resources similar to those that have routinely been undertaken by the United States.
- The proposal has serious anticompetitive consequences in that it acts to reinforce and strengthen the market power of cartels.
- The proposal would invite retaliation against United States exports by our trading partners, or the enactment of "mirror" legislation.
- The proposal is impossible to embody in predictable, enforceable legislation.

STATEMENT

The Coalition to Promote America's Trade is an ad hoc organization of American petrochemical and agricultural companies that was formed in early 1984 to support fair and free trade and to oppose passage of trade legislation focusing on foreign government practices known as "natural resource subsidies." In reviewing the natural resource subsidy provision of H.R. 1950 (section 502), there are two major points the Coalition wishes to emphasize. First, present United States trade law, in particular section 301 of the Trade Act of 1974, already provides a remedy for the complaints that are at the heart of the natural resource subsidy proposal. Not only does the statute specifically address questions of natural resource pricing and access, but some sixty percent of all section 301 cases have been successfully resolved by USTR. Given these facts, enactment of the proposed legislation is unnecessary.

Second, the natural resource subsidy proposal suffers from serious conceptual flaws and would give rise to grave economic and trade-related repercussions.

- Arguments used to justify the proposal are based on a model of private business behavior that is unrealistic, and on a view of the legitimate scope of government activity that is contrary to the United States' own regulatory conduct.
- Enactment of such a proposal would have serious anticompetitive implications and serious trade repercussions.

- The proposal would be unadministrable and foreign compliance virtually impossible.

The Coalition would like to address each of these points in turn.

I. The Natural Resource Subsidy Proposal Is Unnecessary, Because Present U.S. Trade Law Provides a Remedy for the Practices Alleged

Enactment of a natural resource proposal is unnecessary in light of the fact that United States trade law - specifically section 301 of the Trade Act of 1974 -- already provides a remedy for the practices complained of by proponents of the legislation. As is evident from the natural resource debate, the proposal is intended not merely to remedy alleged foreign pricing improprieties, but also to gain access for United States producers to the foreign natural resource at the low internal price. Section 502 of H.R. 1950 demonstrates the importance of access by defining a "natural resource subsidy" to exist only where the price of the resource "is not freely available to United States producers for purchase of that [natural resource] product for export to the United States." An effective natural resource remedy is thus one through which access may be achieved while, at the same time, providing for the imposition of duties or other forms of trade relief in the event access is denied.

The access and pricing issues involved in the natural resource debate are concerns that can be specifically addressed under section 301 of the Trade Act of 1974. This is not merely the view of the PAT Coalition. It is also a view expressed by some of the chief proponents of natural resource legislation. This was made clear in numerous meetings of an industry *ad hoc* working group formed to study the natural resource issue. Industry proponents and opponents of natural resource legislation which participated in these working group sessions included domestic ammonia producers, an ammonia importer, and companies participating in petrochemical ventures abroad. The trade experts of these companies exhaustively studied the issue of natural resource subsidies, including an analysis of current U.S. trade laws and the applicability of those laws to the natural resource issue. *The working group unanimously concluded that "Section 301 provides a potentially effective remedy to questions of natural resource pricing and access*."

Some members of the working group nonetheless believed that legislation should still be sought because section 301 relief is discretionary. However, it is clear from examination of the record in section 301 proceedings that some *sixty percent* of section 301 cases have been successfully resolved by USTR. It is also clear that section 301 is broad enough in scope to address adequately problems of both natural resource pricing and access. Given these facts, there is no justification whatever to change fundamentally the U.S. countervailing duty law to address the natural resource issue. This is especially true in light of the grave economic and trade-related repercussions of such a change in that law.

Section 301 authorizes the President to respond, inter alia, to "unfair" or "unreasonable" trade practices of foreign governments that "burden or restrict United States commerce." Upon the filing of a petition and initiation of a proceeding, the Office of the U.S. Trade Representative may consult or negotiate with the offending country in order to achieve a bilateral resolution of the alleged violation. This is the most typical way in which section 301 actions have been successfully resolved. To the extent such negotiations fail, the President ultimately may retaliate by imposing duties or other forms of import relief, or by taking other action which adversely affects merchandise exported to the United States from the foreign nation. The President's action may be directed against all countries on a nondiscriminatory basis, or solely against the offending nation.

Unlike the countervailing duty (and antidumping) laws, the range of unfair or unreasonable practices covered by section 301 is far more flexibly defined. The conduct that is at the core of the natural resource subsidy dispute -- the denial of equivalent access for United States producers to foreign resources, and the question of reciprocity -- falls squarely within the scope of the statutory language. That a remedy is available under section 301 is especially clear when one examines the amendments to that law that were enacted just last October -- amendments that make explicit the ability of the United States to attack the type of practices at issue here. For example, the law now defines the term "commerce" to include "foreign direct investment by United States persons with implication for trade in goods and services." And the definition of the term "unreasonable" has been expanded to include acts or practices that deny "market opportunities" or "opportunities for the establishment of an enterprise" by United States parties in the foreign nation. These provisions of section 301 thus have as their aim an opening of foreign investment and access opportunities for United States producers -- precisely the concerns addressed by the natural resource proposal.

In addition to its statutory language, section 301 relief is far superior to that available under the countervailing duty (or antidumping) laws. Section 301 relief can be long-term. The ultimate forms of relief available under the statute -- bilateral resolution, duties, quotas, tariff rate quotas, retaliatory action, and the like -- are far more varied than those available under any other unfair trade law. The practices of individual countries may be addressed both individually and flexibly. And the time frame for resolution of such actions in the case of non-signatories to the GATT (e.g., Mexico, Saudi Arabia, the U.S.S.R.) is, by statute, approximately one year -- substantially less than the time frame involved in countervailing duty proceedings, given the numerous opportunities for judicial review of those determinations.

It is true that in the event bilateral consultations fail to produce adequate results, the ultimate relief available under section 301 is discretionary with the President. But, in fact, some sixty percent of all actions under section 301 have been successfully resolved through bilateral consultations between USTR and the offending nation, or, on rare occasions, the imposition of other forms of relief. Included in these figures are actions sucessfully prosecuted against such countries as Canada on certain tax practices, Argentina on leather hides, China on certain restrictive import practices, Taiwan on rice -- countries and products or practices as to which diplomatic and political sensitivities are acute. Given the obvious applicability of section 301 to the pricing and access issues raised by proponents of the legislation, and the track record in other complex and controversial section 301 proceedings, a change of such dramatic proportions as would be involved here to the current countervailing duty law is simply unjustifiable.

II. The "Natural Resource Subsidy" Provision of H.R. 1950 Is Ill-Advised

We would now like to outline our specific concerns about the proposed legislation. A few basic points deserve mention. The thrust of the natural resource proposal is to declare as countervailable the sale by foreign governments of government-regulated natural resources to local purchasers at prices below what is termed a "fair market value" and below the price at which the resource is sold to United States purchasers for export to the United States. The amount of the countervailable subsidy would be the difference between the foreign country's domestic price and the "fair market value" of the resource. The subsidy would be applied against a product made from the resource in the foreign country and exported to the United States.

In determining fair market value, various factors are considered. These include the natural resource product's export price, its generally available price on the world market, whether foreign markets are available to the exporting nation to sell the natural resource, the market-clearing price at which it could be sold in those foreign markets, and whether the exporting nation enjoys a "comparative advantage" in producing and selling the natural resource.

It is clear from the description of the proposal that it does not and is not intended to attack the provision by governments of natural resources at prices below the fully allocated cost of production. Sales below cost can be effectively addressed under the current U.S. antidumping law. Rather, the proposal would radically redefine the concept of unfairness to include situations in which it is determined that government sales -- while made at prices not only above fully allocated cost, but above fully allocated cost plus profit - were not profitable enough. This radical expansion of the countervailing duty law suffers from the following defects:

- The legislation expects governments to behave in a manner different from private enterprises in making pricing decisions.

- The proposal conflicts with the internationally accepted view of the scope of legitimate government activity.
- The proposal condemns government activities in the regulation of a nation's natural resources similar to those that have routinely been undertaken by the United States.
- The proposal has serious anticompetitive consequences in that it acts to reinforce and strengthen the market power of cartels.
- The proposal would invite retaliation against United States exports by our trading partners, or the enactment of "mirror" legislation.
- The proposal is impossible to embody in predictable, enforceable legislation.

A. The Natural Resource Subsidy Proposal Expects Governments to Behave in a Manner Different From Private Enterprises in Making Pricing Decisions

The proposed legislation constitutes a radical departure from U.S. unfair trade laws and accepted principles of international trade. This legislation is designed to condemn not sales below fully allocated cost, not sales made at a handsome profit, but sales made at less than the immediate short-term profit maximizing price. Until the present proposal, the trade laws have never been interpreted to compel enterprises -- private or government-regulated -- to operate at a specified level of profit, let alone engage in short-term rather than long-term profit maximization. Yet this is precisely what the natural resource proposal would do.

This ill-advised expansion of the countervailing duty law is justified by proponents of natural resource legislation as a way to restrain the behavior of foreign governments by limiting them to actions taken by private businesses. The assumption made is that only one market strategy is available to a private company -- that of maximizing short-term profits. In fact, this assumption is often wrong. In forcing governments to pursue short-term profit maximizing strategies as the only way in which downstream products can "fairly" be sold on world markets, the proposal expects governments to behave in a manner that private enterprises often do not satisfy.

In contrast to the simplistic view of private business behavior embodied by the natural resource proposal -- quick sales at the highest price -- diverse market conditions and different attitudes toward risk and long-term growth may lead companies to pursue radically different marketing strategies. Companies may choose to undersell the market in order to trigger an immediate growth in sales. They may lower prices to selected buyers, or seek long-term supply commitments, all in furtherance of longer-term growth. Or a company that sees a potentially lucrative new market for its products may lower its prices to the infant companies that are creating that market to help improve their chances of success. These varied strategies are often adopted by U.S. companies; indeed, they are required by the diversity of the market place. To penalize foreign governments for pursuing similar long-term strategies simply imposes limits on them which U.S. companies have never had to meet. Similarly, to define as an "unfair practice" the failure to reap maximum short-term profits on sales made abroad sets an extremely dangerous precedent which could be used to attack as "unfair" our own U.S. exports.

B. The Proposal Is Contrary to the International Consensus as to What Constitutes a Subsidy and Conflicts with U.S. Development of its Own Natural Resources

Not only is the natural resource proposal based on an unrealistic view of private business conduct, but it also ignores the internationally accepted nature of the government activities involved here. Governments are quite properly motivated by broad general welfare considerations that may result in behavior different from that of a private company. One means by which governments have attempted to improve their nations' general welfare is by developing their natural resources. The impact of such development on their societies may be dramatic.

The fact that a government acts to promote the general welfare of its citizens does not necessarily immunize it from the imposition of countervailing duties under current U.S. law and GATT principles. But the international community has agreed -- and the United States has firmly supported the proposition -- that such actions are exempt if the benefit provided is generally available to all citizens. Both the GATT Subsidies Code and United States law recognize that to be countervailable government benefits must be sector specific in nature. Generally available benefits -- such as U.S. control of oil prices in the 1970's -- have been staunchly defended by the U.S. as non-countervailable. Indeed, the European Community has accepted this argument, and in 1980, it agreed not to initiate a countervailing duty investigation of U.S. petroleum-based products such as synthetic fibers, because the low U.S. regulated price of the natural resource was made generally available throughout the U.S. economy.

Generally available benefits may take myriad forms. For example, a government may distribute part of the income generated from sales of a natural resource directly to its citizens, or use such funds to provide roads, schools, hospitals or food. Alternatively, the government may provide a resource which it owns directly to its citizens at low prices or, by regulation, require that the resource be sold at low prices. The United States has frequently engaged in this type of resource distribution, for example, in selling power generated by federal dams at very low rates, in selling cheap water from government river control projects in the West, or in regulating the prices at which oil and natural gas may be sold. Few examples of greater magnitude exist than the land grant programs sponsored by the United States government during the nineteenth century.

By abandoning the requirement under GATT and our current law that countervailable domestic subsidies be sector-specific, the natural resource subsidy proposal runs directly counter to the long-term interests of the United States. Since a vast array of "generally available" government economic programs can be said to benefit a country's producers, no clear line can be drawn between government action that is countervailable and government action that is not. Using the examples cited above, if generally available inexpensive natural gas is a subsidy, why not water from government irrigation projects benefiting agricultural products? Cheap hydroelectric power produced by government dams? Investment tax benefits to corporations? At the extreme, as noted by the Court of International Trade in a recent decision construing the sector specificity requirement, even public highways and bridges could be considered countervailable government benefits to their users, and "almost every import entering the stream of American commerce [could] be countervailed."[1]

That such a result is not intended with respect to natural resource development was made abundantly clear in the recent Congressional debates on the extension of the contracts that would provide power generated at the Hoover Dam at prices far below market rates. Numerous defenders of the proposal -- of both parties and in both Houses of Congress -- argued that the contracts would allow the government to charge enough to recover costs and earn some profit (though admittedly not the highest possible profit), and more fundamentally, that throughout United States history, the role of government in the development of this nation's resources has never been that of a profit-maximizing entity.

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[1] Carlisle Tire & Rubber Co. v. United States, 564 F. Supp. 834, 838 (C.I.T. 1983).

The bill reauthorizing below-market pricing of hydroelectric power from the Hoover Dam passed both Houses of Congress by substantial margins. The numerous statements made in support of that legislation apply with equal force to the provision of natural resources by foreign governments to their people:

- "The primary purpose of the Federal hydropower program is not to maximize revenue at taxpayer's expense but to sell power at the lowest possible rates . . . and recover the Government's investment and operating expenses." (Rep. Jerry Patterson, D-Cal.)
- "[T]he whole concept of public power was one in which we said Government was not going to make a profit on the power." (Rep. Allan Swift, D-Wash.)
- "There is no subsidy involved. What is involved here is that the whole philosophy of Federal power production is that get cost recovery." (Rep. Mo Udall, D-Ariz.)
- "The Federal Government is not in the power business to make a profit - but to stimulate private development of energy resources. The purpose of the Federal power program has never been to maximize revenue but to sell power from public projects at the lowest possible rates that will recover the Government's investment and pay all operating expenses. The projects should pay their own way -- and Hoover does." (Rep. Howard Berman, D-Calif.)
- "There is no subsidy inherent in the concept of tying the price of power to its cost of production. This is the way 98 percent of all power in America is priced." (Sen. Chic Hecht, R-Nev.)

- "[W]e ought to be pricing the power on the basis of what it costs to produce it." (Sen. James McClure, R-Idaho)

- The Federal Government is not in the business to make a profit. . . . [I]n each of [its] investments we have done it at the lowest possible price in order to give to the people of this country . . . an opportunity to better themselves. . . .

  [The] policy which has been held in this country, in my view, for virtually all of its 200-year history . . . [is] to build this infrastructure for what it costs and to regain those costs, but not to make a profit beyond that . . . . I think it has been a good policy, it is a good policy, and will continue to be a good policy." (Sen. Daniel Evans, R-Wash.)

- "There is no need for the United States to make a profit from federal hydropower resources. . . .

- Clearly the arguments for market pricing are specious. It is against the public interest." (Sen. Barry Goldwater, R-Ariz.)

- "While some will argue that we should not be selling Federal power at below-market rates, the primary purpose of the Federal power program is not to maximize the Government's revenues but to sell power from public projects at the lowest possible rates to consumers that will recover the Government's investment and pay the operating expenses." (Sen. Dennis DeConcini, D-Ariz.)

In short, the regulation and development of a nation's natural resources have long been recognized by the United States as falling within the legitimate scope of government activities, as to which countervailing duties do not apply. No compelling argument has been advanced to alter this view.

C. The Proposal Has Serious Anticompetitive Consequences and Will Strengthen the Market Power of Cartels

The natural resource subsidy proposal provides an exception to countervailability in the event the foreign nation permits United States producer access to the low-priced resource. Where such access is denied -- whether for political or other reasons -- that nation can comply with the proposal only if it raises its internal price of the resource to equal the resource's "fair market value," measured in large part by so-called "world market" levels. In already cartelized markets for certain natural resources, serious economic repercussions would arise from such a pricing measure.

As a matter of economic policy, the lowering of world prices of natural resources to more accurately reflect costs of production should be sought. Instead, however, the natural resource proposal would directly counter this type of positive economic activity. In utilizing "fair market value" to determine the extent to which the internal price of the resource is subsidized, the proposal essentially mandates the use of cartel prices, whenever a cartel exists, as the benchmark against which the subsidy is to be calculated. Undercutting the cartel price is penalized; reinforcing the cartel price is accomplished. This latter point is particularly disturbing when one considers that U.S. law would effectively extend a cartel's price discipline to countries not currently a member of the cartel. A more irrational result -- the legitimizing of inflated world market prices for natural resources -- could hardly be imagined.

The natural resource subsidy proposal would not merely lead to a lessening of competition in the natural resource itself, but also would have an obvious and direct adverse impact on American businesses and consumers. Using natural gas as an example, compliance with the proposal would force the prices of imported energy-intensive products -- such as ammonia -- to rise. The result could well be higher food prices for American consumers. So, too, the prices of imported cement to U.S. industries would rise, further escalating already high costs of construction. While these are but two of innumerable examples, it is clear that the natural resource subsidy proposal has serious commercial implications both at the level of the natural resource and at the level of the downstream product.

D. The Proposal Will Adversely Affect Foreign and Domestic Trade

Enactment of the natural resource subsidy proposal could significantly impede or disrupt United States trade. Disruption would occur not only because of the potential retaliatory actions that other countries might take in response to such legislation, but also because of the effect that the proposal would have on existing purchaser/seller relationships.

Retaliation against United States exports would be likely. As noted earlier, the United States countervailing duty law provides for a general availability test in determining whether a particular domestic subsidy is countervailable. Article 11(3) of the GATT Subsidies Code, enumerating specific examples of possible "domestic subsidies," specifies that such subsidies are those "granted with the aim of giving an advantage to certain enterprises," and are "normally granted either regionally or by sector." These references form the basis for the explicit requirement in United States law that only domestic benefits "provided to a specific enterprise or industry, or group of enterprises or industries" are countervailable.

Last year, the Administration, after close study, concluded that in light of the sector specificity rule, the natural resource proposals considered in the 98th Congress constituted "a drastic and unilateral departure from the internationally accepted definition of a countervailable subsidy," in violation of GATT, and that enactment of such a provision "would subject the United States to a GATT challenge, which we would almost certainly lose. The result could be GATT authorization to retaliate against U.S. exports." The Administration reiterated its position earlier this year in hearings on similar natural resource subsidy proposals before the Trade Subcommittee of the Committee on Ways and Means. The same is true of the present proposal. Likely targets for retaliation would be our own major exports, such as agricultural and textile products. Even if the natural resource proposal were to survive a GATT challenge, it would be a pyrrhic victory, because foreign governments would then have every encouragement to enact their own "mirror" legislation.

Key United States exports would become less competitive on the world market. The adverse impact of the natural resource subsidy proposal on United States exports extends far beyond GATT retaliation or the enactment of mirror legislation. Many United States industries use basic petrochemical and other natural resource-derived products imported from other nations to make more advanced products, which are then exported from the United States. American agricultural interests, petrochemical industries, and the forest products industry, to name just a few, all utilize natural resourcebased products to produce downstream goods for export. If the prices of the basic products are driven up by substantial duties, the prices of the exports of the finished products will also rise, severely undermining or destroying their competitiveness in world markets. The marketplace would thus "retaliate" against United States exports, even if our trading partners did not.

The proposal would seriously jeopardize United States relations with developing countries. Finally, the natural resource subsidy proposal would hit hardest at United States trading partners in the developing world, where regulation of natural resources is frequently an essential part of long-term economic and social development. Indeed, the GATT recognizes the difficult economic situation of the developing nations, by allowing them greater latitude in engaging in subsidy practices without the threat of retaliation. And the United States for decades has repeatedly urged those nations to rely on the development of their natural resources to improve their financial position and the welfare of their people. Enactment of the proposed legislation would clearly undermine the substantial progress made by these countries.

United States exporting industries would also be substantial losers if duties were imposed on products from the developing world. These countries are major purchasers of United States exports: for example, some forty percent of total United States agricultural sales now go to developing countries, and these countries are the key growth market for future United States agricultural sales. It is simply not in the interest of the United States to jeopardize substantial long-term trading relationships with these countries, as would be the case were the natural resource subsidy proposal enacted.

E. The Proposal Is Virtually Unadministrable and Compliance Impossible

In addition to the anticompetitive and adverse traderelated consequences of the natural resource subsidy legislation, compliance with and predictable administration of the proposal are virtually impossible.

The proposal sends a "damned if you do, damned if you don't" signal to foreign governments and producers. Under present United States law, the foreign exporting industry would run afoul of the antidumping statute if the natural resource in question was exported at a price lower than the domestic price of that resource. At the same time, however, under the natural resource proposal, such producers would also be committing an "unfair" practice if the export price of the resource were greater than the price charged in the domestic market. Indeed, such a result would obtain even if there were no exports of the resource in question; under such circumstances, a "fair market value" analysis would govern. Compliance with United States trade laws would thus be virtually impossible for affected foreign exporters, however the natural resource was priced.

The proposal is virtually impossible to embody in predictable, enforceable legislation. The proposal employs terms that are impermissibly vague or impossible to quantify. For example, it specifies certain factors to be used in determining "fair market value," including "market clearing price," "generally available" price in "world markets," "comparative advantage," and "availability of abundant supplies." Although understandable concepts, such terms are not amenable to precise calculation. Moreover, no guidance is provided as to their relative weight, or the manner in which they are to be balanced against the domestic price of the resource. Indeed, as the International Trade Commission stated in its section 332(b) investigation of natural resource pricing, "[f]or a nation that has no current viable natural gas export market, the domestic price cannot be compared to the world natural gas price."[2] The very vagueness inherent in the concepts employed in the proposal underscores the fact that no foreign country, however it priced its resources, could be assured that its practices would comply with United States law. This unpredictability is itself a barrier to trade.

The same indefiniteness also renders unworkable reliance on the "export price," which is one factor that the proposal would consider in determining fair market value. Just as myriad internal prices may exist for a resource, so too, a broad spectrum of export prices may be available for comparison purposes. No guidance is provided, however, for adjusting those prices to reflect vastly different terms and conditions of sale.

The Coalition wishes to express its appreciation to the Subcommittee for this opportunity to present its views on the natural resource subsidy provision in H.R. 1950.

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[2] U.S. International Trade Commission, Potential Effects of Foreign Governments' Policies of Pricing Natural Resources (Final Report on Investigation No. 332-202 Under Section 332(b) of the Tariff Act of 1930) at xv (May 1985).

THE MACROECONOMIC IMPACTS OF IMPLEMENTING NATURAL RESOURCE SUBSIDY LEGISLATION

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Before the

SUBCOMMITTEE ON TRADE
of the
COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES
2247 Rayburn House Office Building
Washington, DC 20515

June 6, 1985

THE MACROECONOMIC IMPACTS OF IMPLEMENTING NATURAL RESOURCE SUBSIDY LEGISLATION

OVERVIEW

Mr. Chairman, I am pleased to appear before this subcommittee to discuss the views of Wharton Econometrics regarding the macroeconomic impact of implementing natural resource subsidy legislation.

Wharton's Long-Term Model of the U.S. economy was used to estimate over the 1986-94 period the direction and size of changes in output, employment, income, and prices which would result following the passage of natural resource subsidy legislation to be effective January 1, 1986. The results of our analysis are extremely disturbing because the jobs which would be saved in the ammonia, petrochemical, carbon black, and softwood lumber industries would be more than offset by job losses in other industries. Net job gains in the protected industries would be at most 9,000, but net economy-wide job losses would reach 275,000. This result occurs under the assumption that the foreign countries directly impacted by natural resource legislation would not retaliate: retaliation would make the net job losses even larger.

Our analysis examined the effects that natural resource subsidy legislation would have on the markets for ammonia, petrochemicals, carbon black, and softwood lumber. Time and resource constraints precluded extending our analysis to include cement. The natural resource input pricing policies for natural gas, carbon black feed stocks, and softwood stumpage were examined for Canada, Mexico, the Soviet Union, Saudi Arabia plus other Middle Eastern countries, and Trinidad-Tobago. The natural resource input prices in these countries were compared with the "fair market value" prices for these inputs as required by the proposed legislation. The latter prices were defined as the export value in the exporting country, or, if the input product was not exported, an estimate of the export value based on the price of the product in a likely export market less transportation costs, existing duties, and processing costs including liquefaction costs for natural gas.

The difference between these two prices was translated into a percentage duty on imports of ammonia, petrochemicals plus carbon black, and softwood lumber. Given that U.S. producers are seeking relief from foreign competition, we assumed that these duties would be reflected in higher product prices for both imported and domestically produced goods. The percentage price increases by product would be 27.1 percent for ammonia (nitrogenous fertilizer), 14.5 percent, on average, for petrochemicals and carbon black, and 14.4 percent, on average, for softwood lumber.

ECONOMIC IMPACTS ASSUMING NO RETALIATION

The U.S. farm sector would be hurt as a consequence of implementing natural resource subsidy legislation. Higher nitrogenous fertilizer costs would lead to a cutback in fertilizer application and a reduction in grain yields, particularly for corn. Higher production costs and lower yields would reduce net farm income on average by $889 million per year over the 1986-94 period. Direct employment in agriculture, including proprietors and employees, would be cut by as much as 41,000. (See Attachments 1 and 2)

Personal disposable income would be reduced by $39.9 billion (1985 dollars) over the 1986-94 period. This personal income loss would be due primarily to the job losses. The chemicals and lumber products sectors would gain at most 9,000 jobs, but job losses in other sectors would be as high as 284,000. Total manufacturing sector employment would be reduced by as much as 65,000. Unemployment rolls would increase by as much as 265,000, while 9,000 workers would leave the labor force. (See Attachments 3 and 4)

The U.S. inflation rate would be higher if the natural resource subsidy legislation were implemented. On average over the 1986-94 period, the producer price index for all commodities would be increased by 0.5 percent. Higher U.S. prices would reduce U.S. real spending power and hinder U.S. export sales. (See Attachment 5)

Total real U.S. output (GNP) would be reduced by $79.7 billion (1985 dollars) over the 1986-94 period. This reduction in total output would follow from higher prices for the products protected by the natural resource subsidy legislation, reduced exports due to higher U.S. prices, and reduced farm output and income. These negative factors would outweigh the gains from reduced U.S. imports. (See Attachment 6)

Reduced employment, income, and output would combine to reduce federal government receipts and raise federal government outlays over the 1986-94 period. By 1994, the federal debt would be increased by $10.5 billion, despite cumulative receipts of $10.4 billion from the natural resource countervailing duty. Federal outlays for transfer payments, including unemployment compensation, would increase by $16.0 billion over the 1986-94 period. (See Attachment 7)

ECONOMIC IMPACTS WITH RETALIATION

If a relatively small country were to impose a duty on the imports of selected products, the likelihood of retaliation is relatively small because the economic cost to other countries is small. Trade restrictions imposed by the U.S. would have a high economic cost; if other countries did not react, they would be making a significant political concession to the United States. Therefore, we think that retaliation is highly likely if the U.S. were to enact natural resource subsidy legislation.

If the United States implemented natural resource subsidy legislation, we believe that the affected foreign countries would retaliate against this legislation by reducing their purchases from the U.S. by at least an equal dollar amount. In retaliation, these countries would attempt to cause the greatest economic and political damage in the U.S. while minimizing the costs to themselves. U.S. grain exports would be a prime target, since wheat and corn are in excess supply in world markets and the U.S. agriculture sector is depressed. We have assumed that Mexico would reduce its imports of corn by a dollar amount equal to their export sales to the U.S., while the Soviet Union would cut its purchases of wheat and corn back to the minimums under the U.S.-Soviet long-term grain trade agreement. Saudi Arabia and Canada would retaliate by cutting their purchases of aircraft and industrial equipment from the United States. (See Attachment 8)

The farm sector would suffer severely from foreign retaliation which would result in annual loss in net farm income of $2.6 billion, during the 1986-94 period, for a cumulative loss in farm income of $23.8 billion. Job losses within the agricultural sector would be as high as 52,000. (See Attachments 1 and 2)

Economy-wide net job losses would be as much as 385,000 under retaliation. These higher job losses would be due to a greater loss in real output (GNP). Over the 1986-94 period, real GNP losses would be $113.9 billion (1985 dollars). Personal disposable income losses would be $58.8 billion (1985 dollars) over the 1986-94 period, with job losses accounting for most of the income drop. The number of people on unemployment rolls would rise by as much as 369,000, and 16,000 discouraged workers would stop seeking work. (See Attachments 3, 4, and 6)

Under retaliation, the federal debt would rise by $33.3 billion, despite cumulative receipts of $10.3 billion from the natural resource subsidy countervailing duty over the 1986-94 period. The sharp increase in the number unemployed would cause federal government outlays for personal transfers to rise by $19.3 billion over the 1986-94 period. (See Attachment 7)

While import duties implemented following passage of natural resource subsidy legislation would reduce U.S. imports of the affected products, a higher overall U.S. price level would encourage increased imports of other goods. These higher U.S. prices combined with foreign retaliation would reduce U.S. exports by more than the drop in U.S. imports. Over the 1986-94 period, the cumulative merchandise trade balance would deteriorate by $13.0 billion. The U.S. and its trading partners would be hurt by the trade legislation because U.S. sales abroad would be cut and foreign sales would also be down. (See Attachment 9)

THE POTENTIAL FOR SUBSTANTIALLY GREATER ECONOMIC COSTS

The ultimate negative impacts of implementing natural resource subsidy legislation on the U.S. and world economies could be much larger than those already enumerated. We have considered the negative effects of only direct retaliation by those countries immediately affected by natural resource subsidy legislation. If the U.S. were to enact this legislation, many European countries could implement similar legislation or enact alternative protectionist measures. If such actions are implemented, worldwide production efficiency would fall, leading to a drop in world output. The losses in U.S. employment, output, and income could be several times larger than estimated here.

ALTERNATIVE GOVERNMENT ACTION

While we believe that enacting natural resource subsidy legislation would damage the U.S. economy, we recognize that the United States is at a serious disadvantage in the international marketplace principally because of the strong U.S. dollar, which makes U.S. industry uncompetitive in many markets. The current problems of the U.S. softwood lumber industry can be attributed largely to the high value of the U.S. dollar relative to the Canadian dollar. Legislative action can contribute significantly to reducing the value of the U.S. dollar. A critical first step would be to enact a major federal deficit reduction program including both expenditure cuts and tax increases. A lower federal deficit would permit an easing of monetary policy and a fall in real U.S. interest rates without the risk of reigniting inflation. As U.S. real interest rates declined, the value of the U.S. dollar should decline. A reduced value for the U.S. dollar would help U.S. exports in many markets and make imports into the United States less attractive.

ATTACHMENT 1

IMPACTS OF NATURAL RESOURCE SUBSIDY LEGISLATION ON THE FARM SECTOR

The price of nitrogenous fertilizers would rise by 27.1 percent as a result of implementing natural resource subsidy legislation. Fertilizer use on grain crops is sensitive to fertilizer prices. As these prices climb, fertilizer applications are reduced. Reduced fertilizer application results in lower grain yields per acre, reduced production, and a loss in farm income. The 27.1 percent increase in nitrogenous fertilizer prices would lead to reductions in corn yield on treated acreage of at least 2.4 percent. Corn production losses would be almost as large because 97 percent of corn acreage is treated. Other major crops such as wheat, cotton, and soybeans would experience similar percentage losses on treated acreage, but the effect on total production would be less because a much smaller percentage of total acreage is treated with nitrogenous fertilizer. While almost all corn acreage was treated in 1984, 76 percent of wheat and other acreage was treated and only 20 percent of soybean acreage was treated.

The agricultural sector would suffer additional income losses owing to export sale losses of these products and to the negative effects of higher corn and soybean costs on meat production. The sizes of these effects were estimated using Wharton's Agricultural Market Models. The expected average annual loss in net farm income due to yield losses, and to the induced effects over the 1986-94 period by major crop, would be as follows:

Crop	Annual Average Net Farm Income Loss (Millions of $)
Corn	$406.
Wheat	153.
Cotton	67.
Soybeans	55.
Total Direct Effects	$681.
Other Induced Losses (Meat Production)	$208.
Total Losses	$889.

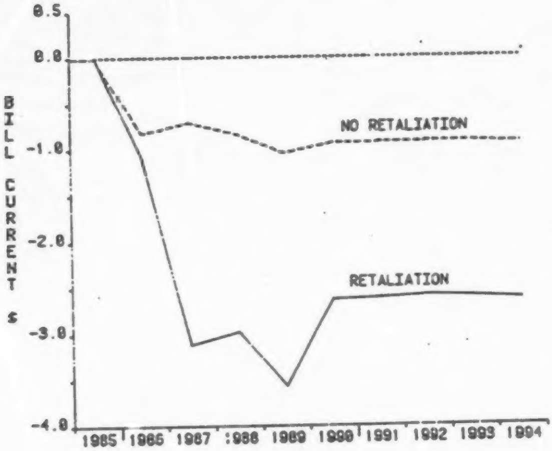
If Mexico and the Soviet Union were to retaliate against natural resource legislation by cutting back their imports of U.S. grains, then the drop in farm income would be increased substantially. The total drop in farm income under the retaliation scenario would be as follows:

Crop	Annual Average Net Farm Income Loss (Millions $)
Corn	$957
Wheat	1,043
Cotton	111
Soybeans	95
Other Products (e.g., Meats)	394
Total Annual Loss	$2,600

ATTACHMENT 2
DECREASE IN NET FARM INCOME

Net farm income would be reduced below baseline levels by a substantial percentage if natural resouce subsidy legislation were enacted. Over the 1986-94 period, the baseline projection for annual average net farm income is $23.7 billion. If there is no retaliation, then the average annual loss in net farm income would be $0.9 billion (3.8 percent) from baseline levels. With retaliation, however, the annual average loss in net farm income is $2.6 billion or 11.0 percent of its baseline average. The following and subsequent charts illustrate the difference from a baseline scenario as a result of implementing natural resource subsidy legislation. The baseline scenario is Wharton's March 1985 Long-Term U.S. Forecast.

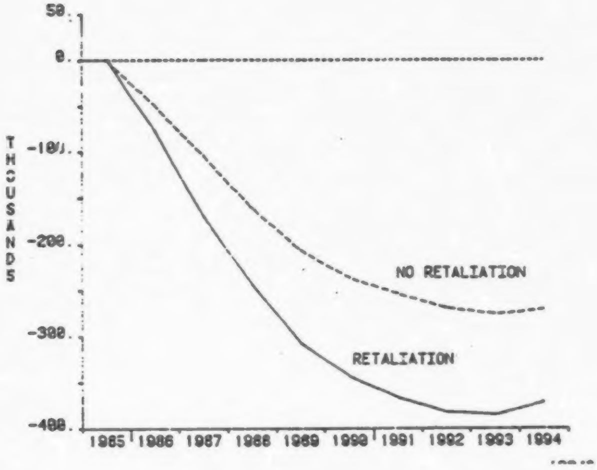
NET FARM INCOME
(Difference from Baseline)



ATTACHMENT 3
JOBS LOST

One of the objectives of implementing natural resource subsidy legislation is to save U.S. jobs which might be lost due to foreign competition. The net result of implementing such legislation, however, would be a loss in U.S. jobs. Without retaliation, job losses would climb to 275,000 by 1993. Under the retaliation scenario, 77,000 jobs would be lost in 1986, and job losses would increase steadily through 1993, reaching 385,000.

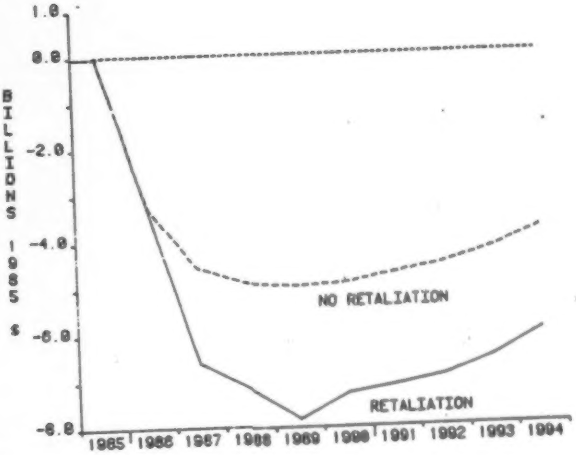
CHANGE IN EMPLOYMENT
(Difference from Baseline)



ATTACHMENT 4
DECLINE IN PERSONAL INCOME

Real personal disposable income would fall below baseline levels, primarily because of the job losses that would occur following the implementation of natural resource subsidy legislation. In the "no retaliation" case, the loss in income over the 1986-94 period would total $39.9 billion (1985 dollars). The cumulative income loss would be $58.8 billion (1985 dollars) if the countries directly impacted by the legislation were to retaliate.

REAL PERSONAL DISPOSABLE INCOME
(Difference from Baseline)



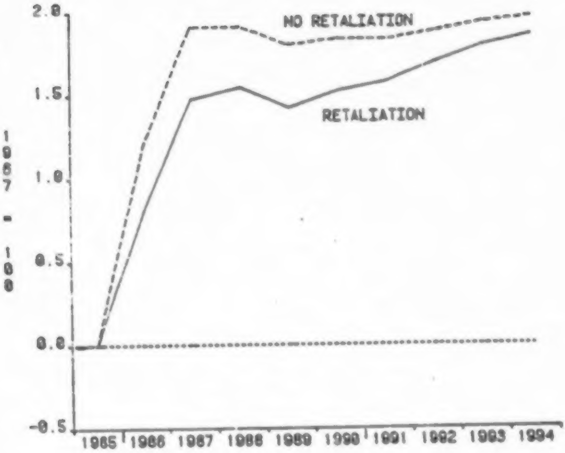
ATTACHMENT 5

INCREASE IN CONSUMER PRICES

The inflation rate would be increased owing to the imposition of duties designed to offset foreign natural resource subsidies. Price levels would increase most rapidly during 1986 and 1987, and prices would remain higher thereafter. Under the "no retaliation" scenario, the producer price index for all commodities would climb to 0.5 percent above baseline levels by 1987 and remain above the baseline by about that percentage through 1994. The change in price levels would be almost as large under the "retaliation" scenario. The following chart illustrates the absolute, not the percentage, difference from baseline.

CHANGE IN PRODUCER PRICE INDEX (ALL COMMODITIES)

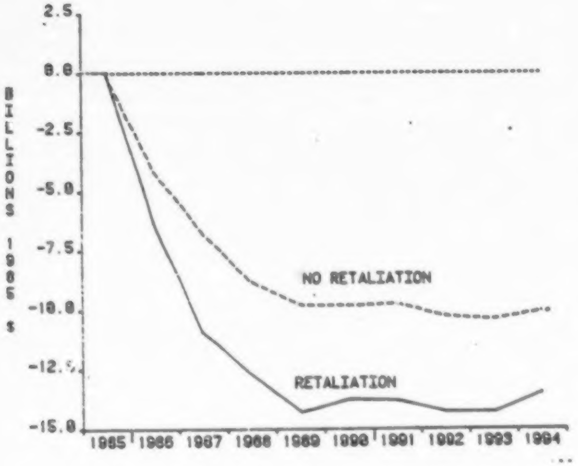
(Difference from Baseline)



ATTACHMENT 6
DROP IN OUTPUT

Employment losses would be accompanied by losses in income and output. U.S. output (gross national product) losses in the "no retaliation" case, over the period 1986-94, would be $79.7 billion (1985 dollars). Under the "retaliation" scenario, total U.S. output would fall below baseline levels in 1986 by $6.3 billion (1985 dollars). This output loss would increase through 1993, when it would reach a level of $13.5 billion (1985 dollars). Over the entire 1986-94 period, the total real output loss would be $113.9 billion.

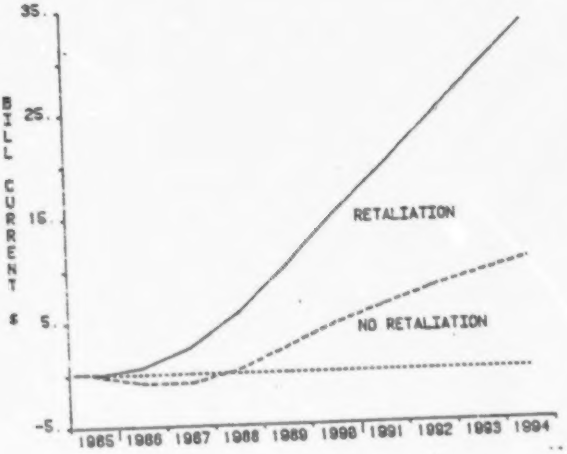
CHANGE IN GROSS NATIONAL PRODUCT
(Difference from Baseline)



ATTACHMENT 7
INCREASE IN FEDERAL DEFICIT

The federal government debt would be higher throughout the 1986-94. In the "no retaliation" case, the federal debt would be $10.5 billion higher by 1994. The federal debt would be increased even though the countervailing duty would yield $10.4 billion in cumulative receipts over the period. Under the "retaliation" scenario, the federal debt by 1994 would be $33.3 billion higher than under the baseline scenario.

CHANGE IN FEDERAL GOVERNMENT DEBT
(Difference from Baseline)



ATTACHMENT 8

THE IMPACTS OF RETALIATION

Implementing natural resource subsidy legislation would cause a total loss of $2.3 billion in sales by foreign countries into the U.S. in 1986. This loss is divided as follows:

Country	Lost U.S. Sales in 1986 (Million $)
Canada	$1,535
Mexico	105
Saudi Arabia	441
Soviet Union	180
TOTAL	$2,261

We assumed that retaliation would be aimed at agricultural commodities (particularly wheat and corn) and at U.S. aircraft and industrial equipment. Mexico and the Soviet Union would be expected to retaliate by reducing their imports of grains from the United States. Mexico is assumed to cut its imports of corn from the U.S. by a dollar amount equal to its lost sales in the United States. We anticipate that the Soviet Union would retaliate by cutting back its imports of wheat and corn from the U.S. to the minimum amounts specified in the U.S.-Soviet five-year long-term grain trade agreement. In 1986, this Soviet cutback would cost U.S. farmers $682 million, while the loss of Soviet sales in the U.S. would be only $180 million. Over the 1986-94 period, the average annual sales loss to the Soviet Union would be $910 million.

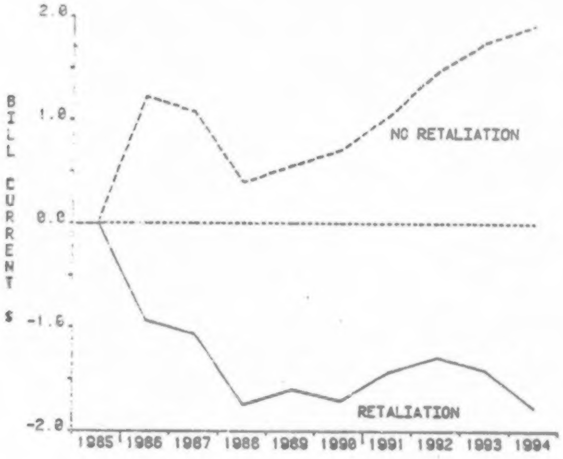
The U.S. sells substantially more to the Soviet Union ($3.28 billion of merchandise in 1984) than it buys from the Soviet Union ($0.55 billion of merchandise in 1984). Therefore, the U.S. cannot cut back its purchases from the Soviet Union by an amount sufficient to offset the Soviet retaliation.

Saudi Arabia is assumed to cut its imports of aircraft and industrial equipment from the U.S. by a dollar amount equal to its lost U.S. sales, while Canada would cut its imports of industrial equipment from the U.S. to offset its lost dollar revenue from the United States. The total cost of these lost U.S. export sales in 1986 would be $2.8 billion, with $0.8 billion being focused on U.S. agricultural products. By 1994, the total loss in U.S. export sales would rise to $3.9 billion, including a $1.2 billion loss of U.S. agricultural product sales.

ATTACHMENT 9
CHANGE IN TRADE BALANCE

Finally, one would expect that the U.S. trade balance would improve if the U.S. were to impose duties to countervail foreign national resource subsidies. Under the "no retaliation" scenario, the cumulative trade balance would be improved by $10.2 billion. However, in the most likely case that retaliation occurs, the U.S. trade balance would be worse every year. Over the 1986-94 period, the cumulative merchandise trade deficit would be increased by $13.0 billion.

CHANGE IN THE TRADE BALANCE (MERCHANDISE)
(Difference from Baseline)



TRADE REFORM ACTION COALITION

October 8, 1985

ADDRESS WRITER AT:

1320 19th Street, N.W.
Washington, D.C. 20036

Honorable James J. Florio
Chairman
Subcommittee on Commerce,
Transportation and Tourism
Energy and Commerce Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Florio:

On Thursday, October 3, I testified before your Subcommittee in support of H.R. 1950, the Trade Law Modernization Act and H.R. 2809, the Comprehensive Trade Law Reform Act of 1985.

Following the testimony of my panel, you directed several questions to the panelists. One of your questions was whether or not we knew if the footwear industry had submitted a modernization plan in connection with its request for relief under Section 201 of the Trade Act of 1974. The question was answered by a TRAC representative in such a way as to cast doubt on whether such a plan had been submitted.

Instead, the answer should have been a most definite yes. The industry submitted a detailed five-year modernization plan along with its 201 petition. Industry witnesses testified at great length on this subject before the U.S. International Trade Commission. I have enclosed a copy of the footwear industry plan with my letter, as well as an executive summary of the plan.

In order to set the record straight, I hope that this letter and a copy of the aforementioned executive summary can be placed in the permanent record of the hearing. TRAC would also be most appreciative of efforts on your part to correct any misimpression that may have been created about this matter with your colleagues on the Subcommittee.

Thank you.

Sincerely,

Jim H. Conner

Jim H. Conner
Chairman

Attachments

Executive Summary

Introduction

The U.S. nonrubber footwear industry recognizes that during a five year period of import relief, it must undertake aggressive efforts to achieve the highest possible level of technological development and marketing competence if it is to narrow the competitive gap enough to assure survival in the years to follow. Consequently, it has already embarked on a Five Year Action Plan which will be the key to accelerating the necessary developments. Given a five year period of meaningful import relief which provides a stable market place for domestic products, major capital investments in new technology and advanced marketing techniques and systems would be experienced.

The Action Plan concentrates heavily in two broad areas - technology and marketing. Industry Task Forces have been at work on the development of these plans.

Technology

A three-phase program has been underway for many months with phase one completed and phases two and three underway.

Phase One: Determine State-of-the-Art and Identify Major Industry Priorities for Technology Development.

With the help of financing provided by a Department of Commerce Trade Adjustment Assistance grant and the extensive cooperation of industry executives, this phase has now been completed. A clear identification of the current state-of-the-art on the 54 most important shoemaking functions has been determined together with the degree of penetration of this advanced technology. In addition, a priority has been established for the most needed technological developments in order to give clear targeting to those interested in addressing these priority needs.

In order to manage this process a New Technology Task Force (NTTF) has been established. This Task Force has already embarked on extensive efforts to educate the industry and suppliers of technology to the needs of the industry and to act as a catalyst in generating development activity. These activities will be highlighted under Phase Two and Phase Three discussions.

Phase Two: Develop Broad Utilization of Existing Advanced Technology.

The FIA New Technology Task Force has created a "Technology Evaluation" concept which, when fully implemented, will offer companies the opportunity to evaluate their currently used technology against state-of-the-art technology in order to pinpoint investment opportunity areas. With work which is now underway in the creation of appropriate investment criteria concepts, such opportunities will be evaluated in order to determine the most cost effective alternatives. From this a comprehensive capital investment scheme for the company being evaluated consistent with its financial resources will be developed.

Existing technology, if fully utilized, offers significant opportunity for reducing break-even selling prices of the U.S. products, thus improving domestic competitiveness. Given a stable investment environment, Phase Two will concentrate on bringing the industry up to the highest possible level of state-of-the-art technology utilization.

Phase Three: Stimulate a Comprehensive Program for Applying Leading Edge Technology to the Target Priorities of the Footwear Industry.

Major opportunities exist today for changing the entire face of shoemaking technology a few years in the future. A comprehensive plan of development has already been engineered by the New Technology Task Force and is presented in matrix form in later attachments. The driving force in this entire concept is the pervasive and revolutionary impact of the computer. Beginning with the application of the computer to the design and pattern grading functions there is an enormous explosion of opportunities which then become possible. The New Technology Task Force sees CAD - Computer Aided Design - as the hub of a wheel (ex. A) from which many spokes offshoot. These are the great opportunities of the future. They are within our grasp and offer major promises of improved productivity, increased material utilization, lower overhead, shortened lead time and superior quality.

Phase Three will be devoted to aggressive efforts to bring about extensive research and development on a new wave of advanced technologies to begin coming on stream in the late 1980's and the early 1990's. A review of the accompanying Phase Three matrix will give some insight as to what developments the NTTF envisions, how the development will be managed, what timetable is possible and what benefits might be expected.

Marketing

The Marketing Action Plan is designed to improve the basic marketing skills and techniques of the industry in a number of significant areas.

A. Product Design - Design and product development training for stylists and line builders utilizing advanced CAD systems. A targeted, consumer-oriented design program can provide the domestic industry competitive advantages in fashion timing, authenticity and efficiency of labor and material utilization.

B. Consumer Research and Education - An active program of consumer marketing and research training, information gathering, and consulting services will provide the industry with essential skills.

C. Sales Management Training - FIA, which already provides an annual skills development program for industry sales managers, will expand to full training so that it is current and effective for all elements of the industry.

D. Strategic Planning at Corporate and Marketing Levels - Training and consultation services in the values and techniques of corporate/marketing planning will yield more consumer-focused activities.

E. State-of-the-Art Sales and Marketing Techniques - Many innovative new marketing techniques (catalogs, direct response, inside selling, telemarketing, etc.) will require accompanying new skills to maximize their effective use. FIA will offer a series of targeted seminars and training opportunities to domestic producers.

F. Export Trading Assistance - FIA will organize a centralized program for the industry which may include a non-competitive product consortium (trading company), education, training, and information - principally governmental - on oversees trade shows, all of which can make the domestic industry more competitive internationally.

G. Computer Software Specific to Footwear Industry - Many software programs are available to marketing management (research, product movement, financial databases, media, simulated test marketing, etc.). FIA will oversee development of universal marketing software specifically designed for the footwear industry. This can make such systems more cost-effective and efficient.